ALAGAPPA UNIVERSITY

KARAIKUDI-630 003, TAMILNADU

DIRECTORATE OF DISTANCE EDUCATION

M.B.A. (Corporate Secretaryship)

(III Semester)

Paper ~~5.5~~ 4.2

CORPORATE RESTRUCTURING: Law and Practice

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Paper 3.6

CORPORATE RESTRUCTURING: Law and Practice

Paper 3.6: CORPORATE RESTRUCTURING: LAW & PRACTICE

UNIT 1 : Introduction

Meaning of corporate restructuring - Need, scope and modes of restructuring - Global scenario - National scenario – Strategic planning - Competitive advantage and core competence - Strategy formulation - Routes for executing strategy - Start up, mergers, acquisitions, takeovers, disinvestments and strategic alliances.

UNIT 2: Mergers And Amalgamations

Concept, need and reasons - Legal aspects - Procedural aspects relating to commencing of meetings and presentation of petition including documentation.

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UNIT 4: Corporate Demergers/ Splits and Divisions and Post Merger Re-Organisation

Difference between demergers and reconstruction modes of demerger - By agreement, under scheme of arrangement, by voluntary winding up - Tax aspects - Tax reliefs - Indian scenario - Reverse mergers.

UNIT 5: Post Merger Re-organisation

Accomplishment of objectives - Criteria of success - Profitability - Gains to post merger valuation - Measuring post merger efficiency - Factors in post merger re-organisation.

UNIT 6: Financial Restructuring

Buy-back of shares - Concept and necessity- Securities and Exchange Board of India guidelines - Government's guidelines - Procedure and practice for buy-back of shares.

REFERENCE BOOKS:

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UNIT I

CORPORATE RESTRUCTURING: INTRODUCTION

This unit will introduce you to the meaning, need, scenarios and strategies and routes in Corporate Restructuring. After going through this unit, you will be able to appreciate that Corporate Restructuring is a necessity in certain circumstances.

MEANING OF CORPORATE RESTRUCTURING

STRUCTURING according to the dictionary means arrangement of parts or a mode of things put together. Restructuring means to give a new structure or to rearrange the existing structure so as to give a new look or a new meaning. In relation to business "Restructuring" means rearranging the business for increased efficiency and profitability. Every organization has its goals and achieving the goals is the primary aim of the organization. To achieve these goals, the organization resorts to various methods and strategies. Restructuring is a method of changing the organizational structure to achieve the goals of the organization.

In relation to other forms of business, Companies are well organized and have complete statutory support. Every Corporate wants achieve his goal, compete fiercely and has the desire to survive under all circumstances. This instinct enables them to resort to different strategies including restructuring. **Corporate Restructuring** is therefore a method adopted by corporate entities to consolidate and strengthen their position in order to attain their objectives both in the near term and longer period. Corporate Restructuring enables the Corporations to be competitive and survive the challenges of the corporate world.

NEED, SCOPE AND MODES OF CORPORATE RESTRUCTURING

What is the need for Corporate Restructuring? The answer is simple. To survive. It can be seen even in the Indian context the structure of many corporate has changed dramatically in the last decade or more. The reason is with the globalization and liberalization of the economy and the ventures of many foreign firms have compelled Indian corporate to restructure. With fierce competition, new methods of production, more quality products hitting the

market and drastic change in consumer preference have all compelled the Indian Corporate to restructure, redefine their strategies and reorient themselves to meet their desired objectives. Simply stated it is the instinct for survival that necessitates restructuring.

The need for corporate restructuring is due to:

a) To focus on the strengths of the organization.

b) To allocate managerial capabilities and infrastructure efficiently.

c) To consolidate economy of scale.

d) To exploit domestic and global markets and

e) To improve corporate performance and survive competition.

SCOPE for Corporate Restructuring is enormous with the changing business profile of corporate world. It includes Cost reduction and improving profitability. If a company wants to grow in a competitive environment it has to restructure itself and that too constantly and continuously. It should pool its resources, reduce cost, economize its expenditure and raise capital at lower cost. It should enhance its profitability and reward its investors. This should be maintained on a continuous basis . In short a company should always be dynamic in this competitive environment and should always be on the look out for the slightest opportunity to consolidate itself. In that case there is enormous scope for a corporate to enhance its potential, discover new and modern strategies and keep itself abreast to the changes around it and ensure its survival.

MODES OF CORPORATE RESTRUCTURING

Restructuring can be of different types. It can be **Financial Restructuring** when an organization wants to expand its capital base, raise resources and enhance capital viability. An organization may resort to **Technological Restructuring** if it wants to achieve technical expertise and technological brilliance. and organizational restructuring. A more comprehensive form of **Organizational Restructuring** can also be resorted to, to improve organizational efficiency, enhance the capability of personnel and make them susceptible to changes.

All these modes of restructuring can be resorted to in any of the following forms:

(a) **Expansion** - through Mergers and Acquisitions, Tender offers and Joint Ventures.

(b) **Sell- Offs** - by means of spin- offs and Divestitures.

(c) **Corporate Control** - through buy backs, Anti-takeovers and proxy contests,

(d) **Changes in Ownership structure** - via exchange offers, going private and leveraged Buy-outs.

The above are a few of the different modes of restructuring. Some of these methods are discussed in detail later. Which of these methods is best suited to an organization will depend entirely on the environment in which the organization exists, its objectives and the treatment necessary to set right its current ills and enable it to achieve the desired goals. It is now a harsh reality that entities have to restructure to survive and the theory of Darwinism that only the fittest will survive makes more sense in the corporate scenario. Globalization has ushered in a change mindset among the companies and there is now virtual scramble for survival. In this context it is necessary to analyze the international and national scenario of Corporate Restructuring.

GLOBAL SCENARIO

Economic reforms and liberalization of economies have made the corporate sit up and take notice. Integration of global economies, market oriented development and more importantly the advent of WTO and the changes it has brought about have fuelled large scale restructuring activity. Any organization exists to satisfy consumers want and need. Globalization has given the consumer many choices of products and brands. Emphasis is now on quality, cost and reliability to mention a few of the traits that a consumer prefers. In order to satisfy this consumer desire, companies are changing and reshaping their strategies and energies and repositioning themselves to meet the challenges created by this shift in consumer preferences. Simultaneously the quantum of funds flowing in different economies have increased manifold and this also has fuelled restructuring to a great extent. For instance, the mergers of AT&T and TCL in the telecom sector, EXXON-Mobile in the oil sector are some of the examples that large funds are flowing across economies and fuelling restructuring.

NATIONAL SCENARIO

Indian economy which was more regulated and controlled till the last decade of the twentieth century has now opened itself up to global competition and has been liberalized to a large extent. In this changed context the Indian corporate also are slowly involving themselves and the restructuring activity is slowly on the rise. The merger of Hindustan Lever Ltd. with Tata Oil Mills and that Roche Products Ltd. with Nicholas Piramal are some of the examples of restructuring by corporates. The list is long but compared to the global scenario the national scene is some what lukewarm. It can be seen increasingly that companies in India are increasingly adopting various modes of restructuring to make their presence felt. So while the global scenario witnesses a high tend activity, the Indian scene which was not so sweeping to start is now gaining momentum and the restructuring activities are on a fast clip.

With this background to Corporate Restructuring, we shall now turn our attention to the strategies to be adopted for restructuring the organization.

STRATEGIC PLANNING

Strategy is an art of giving direction to an organization to achieve its mission. It is a course of action which a firm follows to outwit its opponents. The term strategy implies a set of actions which guide and determine the future course of an enterprise. Strategy is not static. It should be dynamic and should constantly be maneuvered to keep the organization afloat. The central thrust of these decisions is the future of the organization. While any strategy should have a long term vision, it should also provide for medium and short term challenges. A good strategy should effectively align it with that of the environment around. The organization should constantly fine tune its strategy with its ultimate vision and objective in mind.

Strategic Planning is the behavior and a way of thinking of the Organization. It requires diverse inputs from all segments of the organization. It is concerned with the future of the Organization. It is a tool to give direction to the organization in a changing environment. Strategic Planning is vision oriented and conceptual in nature. It enables an Organization to decide what it wants, when it wants, how much it wants in a given scenario. A few of the important elements in strategic planning process are discussed below:

1) **Assessment of changes in the environment**: Continuous monitoring of environmental changes is an important key to strategic planning. It should include analysis of economic, technological, political, social and legal factors.

2) **Evaluation of company capabilities and limitations**: Evaluating once own capability and limitations is also important for strategic planning. The strength of strategic planning is the ability to harness a series of policies, strategies, actions and objectives that gel together to achieve the desired goal.

3) **Assessment of the expectations of the stakeholders:** Any strategic planning process must take into account the interest of the diverse stakeholders in the organization. They include the customers, shareholders, creditors, employees, communities, media, Government etc. Each one has a diverse interest and channeling all of them to the growth of the organization is the essence of strategic planning.

4) **Analysis of the competitors, industry, economy etc:** No organization exists in vacuum. It has to constantly face the challenges not only from the economy, not only from within but also from the competitors. Strategic planning also involves competing with the best.

5) **Formulation of missions, goals and policies**: Strategic planning involves setting targets, fixing bench marks for all areas of the organization. It involves evolving strategies for all situations so that the organization can with stand the changes around it.

Strategic planning is a dynamic process. It depends to a large extent on the culture of the organization. An organization where individual decisions are made is at a disadvantage to an organization where decisions are made by consensus. Similarly a team approach is better than a strong top leadership approach. An organization which learns from the customer is better of than an organization which says "we know what the best is for the customer".

Therefore it can be summed up that strategic planning is based on strategic thinking derived by intuition and logic, is vision oriented and value

based and enables the best utilization of the resources to achieve the objectives of the organization.

COMPETITIVE ADVANTAGE AND CORE COMPETENCE

One of the essential elements of Strategic planning is the analysis of the competitors. The firm has to find out the capabilities and limitations of the existing and potential competitors and their probable future moves. Through this analysis the strengths and weaknesses of the firm in relation to the competitors can be ascertained. The purpose of this exercise is that it helps the organization to assess the competitive advantage it has over the others. Every organization cannot excel in all areas of its operations. It has to ascertain and concentrate on those areas where it has a competitive advantage. It should not hesitate to dispense with those operations where it does not have comparative advantage. Then it can use all its energies and concentrate on that area where it has a distinct advantage.

Core Competency is the essential theme of corporate strategy. A sustainable competitive advantage arises in an organization because that organization has certain special trait that distinguishes it from its competitors. It can be in any area like manufacturing, marketing or service. It is this core competency of the organization that enables it to stand out in a crowd. Every organization over a period of time achieves certain expertise in certain areas. This expertise adds value and is the deriving force to the success of the organization. It may vary but it should not be imitable. It should contribute significantly to the value of the company and enhance its stature among its customers. It should also provide potential access to wide variety of markets. This concept of the Core competency is the most important driving force in the success of the organization.

STRATEGY FORMULATION

The strategy to be formulated by an organization will depend to a large extent on the business goals of the organization. Goals are formulated based on the size, growth, stability, flexibility and technological competence. The firm has to constantly assess itself and ascertain whether its current policies and strategies are appropriate to exploit the opportunities as they come along and

face the potential threats and achieve its goals. At the same time, they should also match the resources of the firm - financial, technological and managerial. The firm then has to work out various strategies and choose the best one which is appropriate to the organization under the existing environment.

Strategic formulation will depend on the approach of the organization. Various theories exist with regard to strategic formulation. **The Boston Consulting group headed by Henderson in 1984** basically emphasized three concepts to formulate strategy. The experience of the organization, the life cycle of the product and portfolio balance are the three concepts that are essential aspects of this theory. **The theory of Michael Porter (1980)** emphasizes on competitive advantage and product differentiation. **The adaptive processes theory enunciated by Ansoff (1965), Steiner (1979) Gray (1986), James (1988)** among others emphasizes on matching resources to investment opportunities. It says that the organization must recognize the dynamics of the competition and economic change and continuously reassess its position and realign itself to the new challenges and opportunities. In the view of this theory the organization is required to make strategic decisions in the face of uncertainty and risk.

METHODOLOGIES USED IN STRATEGY FORMULATION

Different methodologies exist for formulation of strategy. An organization has to use one or more of this methodologies to formulate its strategy for the purpose of restructuring the organization. A few of the more common and useful methodologies in a large number of instances have been dealt with.

a) **SWOT analysis**: An organization has its strengths, opportunities, weaknesses and threats. The strategy to be formulated and the approach of the organization should balance all this four aspects. While it is easier said than done, it is only the judgment and intuition to a large extent will determine how all these four aspects are balanced. If this is done it will help the organization in formulating its strategy.

b) **Synergy:** Synergy represents two plus two equals five effect. The critical aspect of this concept is how the extra gains are to be achieved. The coming together of two organizations each having its strength in different areas – for

example a research firm merging with another not so strong in research but strong in some other area, say marketing, will result in a strong bondage. This concept of synergy can be valid if it has a basis in reality.

c) **GAP analysis:** Goals and Projections analysis is another methodology that can be used to formulate strategy. If any divergence exists between goals and projections, they can be revised and the gap between them can be narrowed.

d) **Competitive analysis:** This methodology assess the different stake holders like the customers, suppliers, creditors etc and also the product of the organization and that of the competitors and arrive at a decision on the suitable strategy to be formulated.

e) **Intuition:** This is a qualitative methodology which primarily is the insights of the brilliant managers. The Managers devise strategy based on experience and more importantly their inner thinking.

Many more methods do exist to formulate strategy but the important aspect is that the method chosen should suit the requirement of the organization. All these methods should take into consideration the product life cycles, the cost advantages, the opportunities that exist and also the profitability of the organization. Then and only then the strategy that will be formulated would be sound and suit the need of the organization.

ROUTES FOR EXECUTING STRATEGY:

Different ways exist for executing the strategy. An organization can restructure in its existing set up, divest or diversify. It can expand, split or go private. But any route or way chosen to execute the strategy should match the strategy and give optimum benefits to the firm. It would depend upon the objectives, attitude towards risk, present nature of its business and technology in use, its strengths and weaknesses, Government policies etc. A few of the strategies are briefly summarized below:

1. Merger

A merger can be defined as the fusion or absorption of one thing into another. It can be also be called as an arrangement whereby the assets of two or more companies get vested in one company which can sometimes be also an entirely new company. The identity of one of the company gets merged with the other company. The shareholders of the merging company get to enjoy

substantial interest in the merged company. In fact, mergers represent resource allocation and reallocation processes in the economy, with the firms responding to the new investment and profit opportunities which arise on account of the changes in economic conditions and technological innovations impacting industries.

Several alternative forms of merger have been distinguished. **A horizontal merger** involves two firms operating in the same of kind of business activity. For example a merger between two pharmaceutical firms will be horizontal merger. **A vertical merger** involves different stages of the operations of the firm. For example in the oil industry where different operations exist like exploration, production, refining and marketing, merger of entities having complementary operations would constitute vertical merger. For example an oil company engaged in production can merge with an oil company engaged in refining. **Conglomerate mergers** involve firms engaged in unrelated type of business activity.

2. Demerger

De-merger is the opposite of merger. Here the de-merged company sells or transfers its undertaking to one or more companies for an agreed consideration. De-merger is a split or division of the company. This is a recent phenomenon in the Indian corporate sector. The de-merger of Larsen and Tubro (L&T) cement division into a new cement company called Ultratech and the proposed de-merger of Reliance Industries and Great Eastern Shipping Company are all examples of de-merger. While no legal definition exists for de-merger in the Companies Act, it can be safely be assumed as an arrangement made by the company to add value to the shareholders and also carry on its business more efficiently and profitably.

3. Amalgamation

Amalgamation is a method of merger. It is a legal process by which two or more companies joint together to form a new company. The amalgamating company loses its existence and the amalgamated company carries on its business with the assets and liabilities of the amalgamating company. Amalgamation is the result of a compromise or arrangement contemplated by Sec. 391 of the Companies Act 1956, and has complete legal · sanction. Amalgamation of Companies in National Interest as provided in Sec.396 and

Amalgamation at the time of liquidation if proposed by the liquidator as provided in Sec. 494 are also possible.

4. Corporate Control

Corporate Control which can be exercised in the form of Premium buy backs, standstill agreements, anti-takeover amendments or proxy contests are also methods of restructuring. **A Premium buy back** represents the repurchase of a substantial shareholder's interest at a premium above the market price and often a condition is added that the shareholder who has relinquished his interest does not attempt to acquire stake in future. **A standstill agreement** is one where the shareholder(s) simply agree not to increase their shareholding which would put them in control of the company. **An anti-takeover amendment** is a change that is made in the corporate bye-laws to make the acquisition of the company more difficult and more expensive like supermajority voting provisions (say 85 percent majority), staggered terms for directors which can delay change of control. In a proxy contest the outsiders who are normally referred to as dissidents try to gain control from the incumbents, i.e the incumbent management is to be changed is the aim of the proxy contest.

5. Slump Sale

In a slump sale the whole or substantially the whole of the undertaking is transferred to another company for a price called as the Slump price. In a lump sum sale the company may not be interested in buying the whole of the undertaking but may prefer a division or divisions and in such cases a lump sum price is fixed without assigning separate price for each division or asset. An agreement is arrived at between the transferor company and the transferee company to sell the entire business as a going concern for slump price.

6. Acquisition

This is a strategy of acquiring control of an organization either by acquiring shares or by participating in the management. The ultimate objective is to acquire a stake in the company through the market and there by control the company. This is not alternative to merger but is often resorted to through the back door and more often than not forcibly.

7. Disinvestment

The Disinvestment commission was established on 23rd August 1996 as an independent non-statutory advisory body to make recommendations on the Public Sector enterprises referred to it. Disinvestment can take different forms, from Government involvement with minority stake or partner with private sector or the Government can hold majority stake with private entities also participating. The Department of Disinvestment has laid down certain procedures for disinvestment on certain aspects like (a) Selection of advisors (b) Short listing of bidders (c) Drafting and finalization of share purchase agreement (d) evaluation by Comptroller and Auditor General etc.

8. Joint Venture

It is another form of relationship between two or more business entities and is widely used by business firms. It is a business policy where by a business entity is formed with two or more parties who share responsibilities on agreed terms and provide capital, technology, expertise etc. Joint ventures with foreign firms and multinational companies not only results in expansion of production capacity or transfer of technology but also enables the domestic firms' access to the global market. Skills and knowledge are shared and fuels growth. Joint ventures also help to diversify risk, achieve economies of scale, augment insufficient ability financially or technically etc. Joint ventures also reduce the financial risk of operating in a particular country. They help to obtain personal contacts, marketing channels, assured source of raw materials and access to local cost and technological information.

9. Franchising

Franchising is a contract between two persons which may be written or oral, expressed or implied whereby the franchisee is granted right to engage himself in the business of selling and distributing goods or services prescribed by the contract. The operation of the business of the franchisee is associated to a large extent with the business, patents, logos, trademarks and ads of the franchiser. The franchisee may operate in a particular territory or only have specified retail outlets. The payments will be made by him direct to the franchiser. This route of business is resorted to only when distributing goods or services that command a high reputation in the market. In some cases the franchisee has to market the product that has to be prepared, treated, assembled,

processed or serviced in a specified way in which cases the franchisee's job becomes more difficult.

10. Strategic Alliances

These are arrangements between two entities with the commercial objective. It is motivated by cost reduction, sharing of technology, market access etc. These alliances have the potential to generate high returns and mitigate the economic risks involved. It is particularly true for new entities. These alliances are now common in areas where large capital and manpower is needed like power, oil and gas. The entire idea is to pool together the resources that are available, facilitate innovative ideas and projects, reduce cost and share benefits. Before entering into any strategic alliance, the firm has to assess its strengths and weaknesses and then formulate its approach. It has to analyze the situation and decide whether it will be prudent to enter into the alliance and also examine the resources it will contribute and the rewards it will reap. Only after this basic decision of analyzing the strategic situation, an entity should formulate the strategic choice of alliance. Then only it will be able to reap the maximum benefits.

We have discussed above the various preliminary aspects of Corporate Restructuring and some of the modes of restructuring. In the lessons to follow, we will look in depth the various procedures, legal, commercial, economical that are involved in these methods.

Review Questions:

1. Corporate Restructuring has become a necessity in the changed global economic scenario. Examine this statement in the light of the scope of restructuring and the global changes that are taking place in this area.
2. Strategic planning is necessary for restructuring - Do your agree?
3. Core Competence is the essence for any organization - Elucidate.
4. Explain the national scenario of Corporate Restructuring.
5. Strategy formulation is more important than restructuring - why?
6. Discuss any two methods of executing strategy.
7. Explain the role disinvestment plays in restructuring.

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UNIT – 2

MERGERS AND AMALGAMATION

INTRODUCTION

We discussed a few methods of restructuring briefly in the earlier study. We will now discuss the most common and prevalent of these methods in this unit. Merger and Amalgamation have now become an integral part of corporate strategy. Merger is the fusion of two undertakings into one entity for the purpose of business convenience, economies and profitability. Merger is an arrangement made between companies for the purpose of restructuring themselves. If an organization decides to merge, it has several options before it. It can merge with another entity and lose its identity. It may opt to merge with another company to form an entirely new company. It can acquire an existing company. We discussed in the last study that any method that is chosen by the organization for restructuring should be in conformity with the broad policies and goals of the organization. In other words, it should suit the organization, its culture and ethos.

We had also seen that globalization has created a sense of survival instinct among the corporate. They have also realized that by restructuring they can attain dizzy heights in the corporate world. So in this scramble for restructuring, many methods are followed. But the most common of them has been merger and amalgamation. It is pertinent to note that merger as a method has its genesis even at the fag end of the nineteenth century.

CONCEPT, NEED AND REASONS

Merger is the fusion of two companies into one entity. The company that merges known as the merging company transfers all its assets and liabilities to the other company called as the merged company. The shareholders of the merging company become the shareholders of the merged company. The shareholders of the merging company will be allotted shares in the merged company as per the ratio agreed as per the scheme of merger in exchange for shares held by them in the merging company. The scheme of merger as approved by all concerned shall form the basis for allotment of shares and transfer of the business.

Amalgamation is an "arrangement" or "reconstruction". It has legal sanction. Amalgamation is a process in which two are more companies are joined together to form a new company called as the amalgamated company. It may also be possible that two or more companies are absorbed or fused with one another to form a new company called as the amalgamated company and the amalgamating companies lose their existence. According to the Accounting Standard 14 (AS-14) issued by the Institute of Chartered Accountants of India, amalgamation means an amalgamation pursuant to the provisions of the Companies Act 1956 or any other law. It may be in the nature of amalgamation by merger or amalgamation by purchase. In the amalgamation by purchase one company's assets and liabilities are taken over by another for a consideration.

The terms Merger and Amalgamation are used synonymously in many instances. The commonality between the two is that two entities with long term business interest combine to form a new entity to share risk and reward. But **Merger** is a method whereby two entities fuse together with the aim of expanding, diversifying or acquiring technology, expertise or capital or choose partners with the long term aim of corporate growth. In some cases it is done to review sick units. **Amalgamation** on the other hand is an arrangement to bring together the assets of two companies under the control of one entity.

REASONS FOR MERGER AND AMALGAMATION

Is there any justification for merger and amalgamation? What is the necessity for an organization to resort to merger and amalgamation? The reasons are not far to seek. We have already observed that organizations desire continuity and also want to keep pace with their competitors. Therefore wherever there are managerial weaknesses or the cost of production is high or there is any reason whereby the firm cannot balance itself with the environment around it then it is necessary for the firm to restructure through a merger or amalgamation. **Company's growth** is the ultimate aim and is the driving force behind any merger or amalgamation. This is particularly true when the organization growth is restricted due to scarce resources. In such cases the managerial capability plays a very important role. Similarly **reduction of cost and increasing profitability** also dominate the mindset of the management and to achieve this also merger and amalgamation are resorted to. We can now

briefly look into some of the reasons that drive the management towards merger and amalgamation.

1. Aligning the Firm to the Changing Environment

There always exists a gap between the objectives of the organization and the potential of the organization based on its present capabilities. Every organization wants to bridge this gap. In order to do that, it decides to adopt several ways and means that suit the organization. But the ultimate aim is that the organization wants to keep itself afloat and the ever changing environment compels the organization to resort to changes. Changes can be product related, technology related, market related etc and to effect these changes the organization can resort to merger or amalgamation with another organization which will enable it to align itself with the environment.

2. Increased Technological Change

There has been a virtual technological revolution in the area of product development. The increased pace of product development shortens the life cycle of the product. New products are constantly introduced at a very fast pace. In such a situation the organizations which keep pace with these developments will only survive. To ensure this survival the organization will have to resort to restructure by merging or amalgamating with another organization which is more capable of keeping pace in technological capabilities.

3. Reducing Cost

Increased production reduces cost. As the volume of production increases, the per unit cost of production is reduced. This is due to the fact that the fixed cost remains spread over a large volume of production. If there is merger or amalgamation, there will be expansion of volume of production and consequent reduction in per unit cost. In this way the firm can improve economies of scale. A combined firm with a large size can make optimum use of resources and thereby reduce prices, increase market share and earn higher profits.

4. Market Leadership

Merger and amalgamation also resorted to attain market leadership. Merger and amalgamation enhance value for the stakeholders of both

companies. As the costs are reduced, the market share increases and the new company carve out a niche for itself in the market. It can easily garner a major market share and attain market leadership.

5. Acquiring New Products and Brands

The pace with which new products are introduced reduces life cycle of the product. An organization however capable it is, cannot always keep pace with this change. Moreover development of a new product increases cost and takes time. In such a scenario, merger and amalgamation come in handy. Merger and amalgamation enables the company to get new brands and add new product which it will otherwise not acquire easily.

6. Financial Synergies

A merger or amalgamation also enables an organization to develop financial synergies like eliminating financial constraints, deployment of surplus cash, enhance debt capacity and also reduce the cost of finance. A financially wealthy company would have idle surplus which can be profitably used. At the other extreme, where an organization is insolvent and is starved of cash, it would badly need cash to carry on its operations. In either case, merger or amalgamation gives financial leverage and synergizes the financial position.

CATEGORIES OF MERGER

Mergers can be classified into two broad categories:

(a) **Cogeneric Mergers**: Those that take place within the same industry.

(b) **Conglomerate Mergers**: Those that take place between unrelated businesses.

Cogeneric Mergers

Cogeneric Mergers are of two types:

(a) **Horizontal Mergers:** These types of mergers are between same type of companies, that is, companies that are carrying on the same type of business or rendering the same type of service. Horizontal merger reduces the number of companies, gives synergetic effect, eliminates duplication and increases profit. But the problem of this type of mergers is that it creates monopolistic trends in the industry.

(b) **Vertical Merger:** In a vertical merger, organizations having complementary operations merge with one another. This results in operational synergy as well. For example a pharmaceutical company dealing production can merge with one dealing in marketing, so that both production and marketing will come under one administration and control and there by attain growth and profitability. It reduces monopoly compared to horizontal merger, in that, only companies with complementary facilities merge. Vertical merger can be further classified as backward or forward merger depending upon the company with which it merges. If it merges with a company supplying raw materials it is backward merger and if it combines with a company engaged in marketing then it is forward merger. In either case, the vertical merger results in smooth operations for the industry.

Conglomerate Merger

Conglomerate merger is between two companies which are not related in business in any manner. It is neither a horizontal relation nor vertical. There is no commonality either in the raw material or end product or the service to the society. The companies are neither competitors nor complementary to each other. There are also not suppliers or consumers of the same product. They operate in unrelated market. The aim of such mergers is to explore investment opportunities reduce cost of capital and also utilize the low cost internal funds of the acquiring firm. Conglomerate merger can be either a **Financial Conglomerate** or a Managerial **Conglomerate**. Financial Conglomerates provide flow of funds, exercise control and are the ultimate financial risk takers. Managerial Conglomerates provide managerial counseling and interaction on decisions and increase the potential for increasing performance.

Other Merger Types

There are other merger types which have the attributes of the above mentioned broad categories. They are less common. They may be **De-facto merger** where there is merger as per law but in practice it is only acquisition. If certain shareholders are required to accept cash for their shares it is called as **Cash merger**. If the merger is between the parent and its subsidiary it is **Down stream merger** and if it is vice versa it is **Upstream merger**.

METHODS OF MERGER OR AMALGAMATION

Merger or Amalgamation can be resorted to by any of the following methods:

- Merger under a scheme of Compromise or Arrangement as contemplated by Sec.391 of the Companies Act 1956
- Merger by purchase of shares.
- Merger or amalgamation in national interest as contemplated by Sec.396 of the Companies Act 1956.
- Merger under Sec.494 of the Companies Act 1956, at the time of liquidation.

These are the broad categories, though a permutation and combination of the above types is also feasible. Moreover, any company deciding to resort to merger or amalgamation, before initiating any legal steps has to undertake a lot of preliminary work relating to merger or amalgamation. Any restructuring activity in the corporate world has to be planned and executed in such a way that it gives optimum benefits to the organization. To achieve this organization has to carefully select the partner, conduct a SWOT analysis, compare cost and profit, assess the suitability and time the activity in such a way that it derives maximum benefit.

LEGAL ASPECTS OF MERGER

The legality for merger is derived from the Companies Act 1956. In fact, the other mercantile legislations like the Partnership Act or the Industries (Development and Regulation) Act do not have any provision for merger or amalgamation. The Companies Act 1956 vide Sec. 390 to 396A deal broadly with the merger or amalgamation or any other similar activity. Sec.391 of the Companies Act 1956 lays down the power to make a compromise or arrangement by company with its creditors or members either as a going concern or even at the time of liquidation. Sec.392 and 393 broadly outline the information to be provided in a Compromise or arrangement and also the power of the High Court to enforce it. Sec.394 and 395 facilitate reconstruction and lay down the modalities for acquiring the shares of the dissentient shareholders. Therefore Sec.391 and 394 are the two important sections that deal with a Compromise or arrangement that can enable the company to merge or amalgamate. In fact, these provisions are the complete code for an effective

merger or amalgamation, in that, they are not only statutorily protected, but also enables the organization to obtain the stamp of approval of a judicial authority. Viz. the High Court. We will now see briefly what are the salient features of these two sec.391 and 394.

i) There should be a scheme of Compromise or Arrangement for restructuring or amalgamation. This can be either with the members or creditors or both.

ii) The scheme of Compromise or arrangement should be initiated through an application to the court for direction for holding a meeting of shareholders/creditors.

iii) The court may order a meeting of shareholders/creditors and the meetings are to be held as per the court's direction.

iv) The scheme of compromise or arrangement should be approved by 3/4th value of creditors or members or their class as the case may be.

v) The scheme as approved by the General body should be sanctioned by the court after hearing the dissentient shareholders.

vi) The court order will be effective only after a copy of it has been filed with the Registrar of Companies.

vii) The court's order is binding on all the shareholders/creditors/company.

viii) The court's order is appeal-able.

Thus a merger or amalgamation can be resorted to in any of the following ways.

a) **Transfer of undertaking by order of the High Court (sec.394 of companies act)**

The court can sanction a scheme of merger or amalgamation based on a compromise or arrangement between two companies which has been approved by a majority of shareholders (holding more than 75 percent shares). Before doing so the court serves a copy of the petition on the Regional Director (CLB) and if there is no objection, sanction the scheme.

b) **Purchase of shares by one company by another company: (sec.395)**

The second mode of merger or amalgamation contemplated by Sec.395 is the take over of an undertaking by purchase of shares of company by another

company. This dispenses the need to obtain court sanction. The company purchasing shares should comply with SEBI Regulations 1997 regarding substantial acquisition of shares and takeovers and Sec372A of the Companies Act 1956.

c) **Amalgamation of Companies in National interest**: **(sec.396)**

This type of amalgamation is done through a notification by the Government, where the Government is of the view that an amalgamation of two or more companies is desirable in public interest. The notification will also lay down the constitution, power, rights, interest, privileges, liabilities, duties and obligations of the amalgamated company.

d) **Amalgamation of companies under sec.494:**

Amalgamation is also possible under Sec.494 of the Companies Act, where the liquidator of the company transfers its assets and liabilities to another company.

PROCEDURAL ASPECTS OF MERGER AND AMALGAMATION

Merger and Amalgamation as contemplated by the Companies Act 1956 vide sec.391 to 394 is the most complete and common mode of obtaining merger and amalgamation. As the court is actively involved in the process, the legal sanctity also gets enhanced to a large extent. Sec.391 to 394 read with the Companies Court rules 1959 (rules 67 to 87) serves as a complete code for merger and amalgamation.

A Company which wants to merge or amalgamate in terms of the above provisions requires different approvals as contemplated by the procedural rules. The following approvals are required in any merger or amalgamation.

a) **APPROVAL BY THE BOARD**

Any proposal for merger or amalgamation should originate from the Boards of both the companies. The board resolution should approve the scheme in principle and also an authorize an official of the company to complete the formalities like filing the petition in the court and such other things that are necessary or expedient. It is important to note that any scheme of amalgamation or merger should contain all of the following provisions as contemplated by the rules.

- Capital structure of the transferor and transferee companies.
- The share exchange ratio.
- Transfer of undertaking and liabilities of the transferor company to the transferee company from the appointed date.
- The scheme should provide for an appointed date (the date from which merger or amalgamation takes place) and effective date (actual date of coming into effect of the scheme.
- Continuance of legal proceedings of transferor company by transferee company after the effective date.
- Transferor company to carry on business on behalf of transferee company between the appointed date and effective date.
- Services of transferor company's employee, their services and benefits.
- Objects of the transferee company after merger or amalgamation.
- Dissolution of the transferor company on the effective date.

After this preliminary approval by the board to the broad contours of the scheme of merger or amalgamation, the company has to initiate proceeding in the court in terms of the Company (court) rules 1959.

PROCEDURE FOR PRESENTATION OF PETITION AND CONDUCT OF MEETINGS

1) The petition for merger or amalgamation is to be presented by the company under Sec.391 (1). The petition should be supported by an affidavit, stating all material facts relating to the company, the latest financial position of the company and the latest auditor's report. A copy of the scheme merger or amalgamation should be annexed to the affidavit as an exhibit. The copy of the proposed scheme should give full details of the scheme, the parties to be affected, the benefits to the shareholders etc. The summons for direction to convene a meeting under Sec.391 should be in Form no.33 of the Company (court) rules 1959. **(Refer Annexure I).** In case of merger or amalgamation the petition should also seek the leave of the court for appropriate orders for reconstruction or amalgamation in terms of sec.394.

After hearing the parties concerned on the petition filed for merger or amalgamation, the court can give directions for holding a meeting of the shareholders/creditors of the Company to decide on the scheme of merger or amalgamation as submitted to the court. The directions can include the time and place of the meeting, chairman to preside over the meeting, the quorum for the meeting, voting by proxies and the time within which the result is to be reported back to the court.

The court before giving directions for holding the meeting of shareholders for approving the scheme of merger or amalgamation shall prima-facie satisfy itself regarding the legality and fairness of the scheme because there is no point in taking an illegal and unfair proposal before the general body.

2) After getting the approval of the court for holding the meeting of shareholders/creditors, the company shall arrange to convene a meeting of the general body. Notice for the meeting should be sent individually to all the members or creditors by the Chairman of the meeting in the format given in Form no.36 **(Refer Annexure II)**. The notice should be given 21 clear days in advance as contemplated by the Companies Act 1956 for any General Meeting. It should be accompanied by a copy of the scheme of merger or amalgamation and the statement as required under Sec.393 of the Act. The notice should also contain a proxy form as per the format in Form no.37 **(Refer Annexure III).**

3) It is incumbent on the Chairman of the meeting to issue the notice. The notice should also disclose all material facts regarding the proposed scheme of merger or amalgamation and also disclose material facts like the interest of the directors and other managerial personnel and their effect on the scheme. Any member or creditor desiring to have a copy of the scheme shall be provided with one free of charge.

4) The chairman appointed for the meeting or any other person directed to issue notice of meeting shall inform the court through an affidavit in terms of Rule 76 of the Company (court) rules 1959, not less than seven days before the meeting, that the directions of the court for issue of notice have been complied with. If there is default the court may order and fresh notice to such of those members and also postpone the date of hearing of the petition.

5) The proxies for the meeting should be in the prescribed form. The proxy form for a meeting of merger or amalgamation as directed by the court is a two way proxy form where by the member can direct the proxy to vote for or against the scheme. The proxy form should be deposited at least 48 hours before the meeting. The proxies can speak at the meeting and they will also be counted for the purpose of quorum.

6) The decision of the meeting should be ascertain as per rule 69 should be ascertained only by means of a poll and all the members present in person or proxy shall be entitled to vote. The resolution approving the scheme shall be voted by a simple majority of the members present at the meeting and the members voting for the scheme should also hold 75% of the value of shares. In other words both the criteria, that a simple majority of members present and also members holding 75% in value of shares should be satisfied.

7) 7) The minutes of the meeting should be finalized in consultation with the chairman of the meeting and should be signed by him once it is finalized. The chairman shall report to the court the outcome of the meeting and also file a copy of the minutes of the meeting. The report should be submitted in Form no.39 **(Refer Annexure IV)** as per rule 78 of the above rules. It should state accurately the number of members/creditors who attended the meeting, the number of persons who attended in person and number represented by proxy. He must also state as to how the members voted and the value of their votes.

8) If the proposed scheme of merger or amalgamation is approved by the shareholders of the company, a petition is to be presented to the court for confirming the scheme as approved by the members. The petition is to be made by the company in case of merger or amalgamation after the chairman of the meeting has filed his report. The petition is required to be made in Form no.40 **(Refer Annexure V)** of Company (court) rules 1959. The court shall fix a date for hearing of the petition and require the company to issue notice of the date of hearing. It should also direct that the date of hearing should be intimated to the Regional Director, Registrar of companies etc.

9) The court on hearing the company regarding the scheme and objections if any in this regard from any dissenting shareholder and also the Regional Director and Registrar of companies if need be confirm the scheme of

merger or amalgamation as approved by the members. The court order confirming the scheme shall be in Form no.41. The copy of the court order sanctioning the scheme shall be filed with the Registrar of Companies as contemplated by Sec.391(3) and Sec.394(3). The order shall be filed in Form no.21 of the Companies Central Government General rules and forms 1956.

10) The scheme once confirmed by the court shall be binding on all members of the company. The order of the court confirming the scheme can be appealed against. But it must be remembered that the members of the company are the sole judges for approval of the scheme and it is not possible for the court to decline any scheme of merger or amalgamation unless it is patently illegal. The Bombay high court has held in the case of Sadanand S. Varde Vs State of Maharashtra (2001) SCL 268 (Bombay) that the concept of Sec.391 to Sec.394 are complete in themselves and the court does not have any special jurisdiction under Article 226 of the Constitution. The courts cannot sit in judgment over the correctness of the order made under sec.391 which has become final, conclusive and binding.

APROVAL OF RESERVE BANK OF INDIA

Approval of the Reserve Bank of India will become necessary if the scheme of amalgamation or merger requires that shares to be issued to Non-Resident Indians as a part of the scheme. The Foreign Exchange Management Regulations 2000 regarding transfer or issue of security by a person resident outside India require the permission of RBI for issue of shares to Non-Resident Indians. The regulations stipulate that when a scheme of merger or amalgamation of two or more Indian companies is confirmed by the court, the transferee company may issue shares to persons resident outside India subject to:

(a) The percentage of shareholding by persons resident outside India does not exceed the percentage approved by the Government to Reserve Bank of India.

(b) If the percentage is exceeded consequent to the issue of shares as per the scheme, prior approval of the Government is to be obtained before applying to the RBI for approval for issue of shares.

(c) The transferee company shall not carry on the business of agriculture, plantation or real estate.

(d) The transferee company must give a declaration in the report to be filed with the RBI that it has complied with the directive of the Government as given in the approval and also furnish full details of shares held by persons outside India.

ROLE OF CENTRAL GOVERNMENT IN AMALGAMATION

The provisions of the scheme of merger or amalgamation do not envisage any active role for the Government in the scheme of things. However, the Central Government can act as an impartial observer in the entire scheme of things and can act only if there is prejudice to public interest. Moreover Sec.391 of the Companies Act 1956, stipulates that notice of every application made to the court under the provisions of the scheme of merger or amalgamation shall also be given to the Central Government. It is also incumbent on the court to take into consideration any representation of the Government before it passes any order on the petition of the company.

AMALGAMATION OF COMPANIES BY CENTRAL GOVT

Sec.396 of the Companies Act 1956 empowers the Central Government to order amalgamation of two or more companies if it is satisfied that the amalgamation is necessary in public interest. This power of the central government is without prejudice to the provisions contained in Sec.394 and 395.

This power of the central government can be exercised on its own volition also without any request from any quarter. The order shall stipulate the powers, rights, interests, privileges, duties and obligations as may be specified. The order passed by the Government shall be published in the Official Gazette and a copy of the order shall be sent to each of the companies to be amalgamated.

ANNEXURE I

FORM NO.33

(under the Company (court) rules 1959

(Rule 67)

Company Application No. of 20

……………………….Applicants

Summons for directions to convene a meeting under Sec 391

Let all parties concerned attend the Judge in Chambers on ………….. Day, the ……………day of ……………..20….at…..o'clock in the ………noon in the hearing cf an application of the above named company (or of the applicants above named) for an order that a meeting (or separate meetings) be held at ……*. of the above company for the purpose of considering and if thought fit approving with or without modification a scheme of compromise or arrangement proposed to be made between the company and the said ………*.of the said Company.

And that direction is given as to the method of convening, holding and conducting the said meeting(s) and as to the notices and advertisements to be issued.

And that a Chairman (or Chairmen) may be appointed of the said meeting(s) who shall report the result thereof to the Court.

Advocate for the applicant(s)

Registrar

The Affidavit of ………will be used in support of the summons.

* Here indicate the members/creditors/their class.

ANNEXURE II

FORM NO.36

(under the Company (court) rules 1959

(Rule 73)

Company Application No. of 20

……………………..Applicants

Notice convening Meeting

To

………….

………….

Take notice that by an order made on …………20…. the Court has directed that a meeting of (members/creditors) of the company be held at ……on the……day of …….20…at ….o'clock for the purpose of considering and if thought fit, approving, with or without modification, the Compromise or arrangement proposed to be made between the said Company and (members/creditors) of the Company.

Take further notice that in pursuance of the said order, a meeting of (members/creditors) of the Company will be held at ……on…..day, the ….day of ……20….when you are requested to attend.

Take further notice that you may attend and vote at the said meeting in person or by proxy provided that a proxy in the prescribed form, duly signed by you, is deposited at the Registered office of the Company ……not later 48 hours before the meeting.

This Court has appointed Sri ………… and failing him Sri…….. to be Chairman of the meeting.

A copy of each of the Compromise or arrangement, the statement under Sec.393 and a form of proxy is enclosed.

Dated this ………day of ………20…..

Chairman appointed for the meeting

ANNEXURE III

FORM NO.37

(Under the Company (court) rules 1959

(Rule 73)

Company Application No. of 20

……………………..Applicants

Form of Proxy

I, the undersigned (a member) of the above Company hereby appoint AB of etc., and failing him CD of etc., as my proxy, to act for me at the meeting of (members) to be held at……….on the ……..day of ………20…at…..o'clock in the …….noon, for the purpose of considering, and, if thought fit, approving with or without modification, a Compromise or arrangement proposed to be made between the said Company and its (members) and at such meeting and any adjourned meeting thereof, to vote, for me and in my name ……..(here, if for, insert 'for', if against, insert against, and in the latter case, strike out the words below after Compromise or arrangement) the said Compromise or arrangement either with or without modification as my proxy may approve.

(Strike out what is not necessary)

Dated this ……………..day of ……….20…

Signature

Address:

ANNEXURE IV

FORM NO.39

(Under the Company (court) rules 1959

(Rule 78)

Company Application No. of 20

……………………..Applicants

REPORT BY CHAIRMAN

I, X, the persons appointed by this Hon'ble Court to act as Chairman of the meeting of (shareholders/creditors*) of the above-named Company, summoned by notice served individually upon them by advertisement dated the ………day of ……..20…..and held on the …….day of …….20….at …….do hereby report to this Hon'ble Court as follows:

1. The said meeting was attended either personally or by proxy by …….(state the number of members/creditors who attended) of the said Company entitled together to ……..(mention the total value of debts/shares as the case may be) of those who attended the meeting.

2. The Compromise or arrangement was read out and explained by me to the meeting, and the question submitted to the said meeting was whether the ……(members/creditors) of the said Company approved of the Compromise or arrangement submitted to the meeting and agreed thereto.

3. The said meeting was unanimously of the opinion that the Compromise or arrangement should be approved@ and agreed to /or the result of the voting upon the said question was as follows:

The under-mentioned (members/creditors) voted in favour of the proposed Compromise or arrangement being adopted and carried into effect:

Name of the Creditor/member	Address	Value of debt / Shares	Number of Votes
1.			
2.			
3.			

* here mention members or their class and the type of shares / creditors.

@ If the Compromise or arrangement was approved with modification it should be so stated and the modifications made should be set and also the particulars of the voting on the modifications.

The under-mentioned (here mention the class of creditors or members who attended the meeting) voted against the proposed Compromise or arrangement being adopted and carried into effect:

Name of the Creditor/member	Address	Value of debt / Shares	Number of Votes
1.			
2.			
3.			

Dated this ....day of ....20.....

(Sd.) X

Chairman

ANNEXURE V

FORM NO.40

(Under the Company (court) rules 1959

(Rule 79)

Company Application No. of 20

.........................Applicants

Petition to sanction Compromise or arrangement

The petition of AB & Co ltd ......the petitioner above named is as follows:

1. The object of this petition is to obtain sanction of the Court to a Compromise or Arrangement whereby (here set out the nature of Compromise or arrangement)

2. The Company was incorporated under the ......Act ....with a nominal capital of Rs........divided into ....shares of Rs.......each of which ......shares were issued and Rs......was paid up on each share issued.

3. The objects for which the company was formed as set forth in the Company's memorandum of association. They are in brief: (mention the main objects)

4. (Here set out the nature of business, financial position, the reasons for Compromise and the benefits likely to be derived.)

5. The Compromise or arrangement was in the following terms: (Here set out the terms of the Compromise or arrangement)

6. By an order made in the above matter on ....20.....the petitioner was directed to convene a meeting of (members/creditors) of the Company for the purpose of considering, and, if thought fit, approving with or without modification, the said Compromise or arrangement and the said order directed that X or failing him Y should act a Chairman of the said meeting and should report the result thereof to this Court.

7. Notice of the said meeting was sent individually to the (members/creditors) as required by the order together with a copy of the Compromise or arrangement and of the statement required by Sec.393 and a form of proxy. The notice of the meeting was also advertised as directed by the said order (here give the names of news papers)

8. On the .....20.... a meeting of (members/creditors) of the Company duly convened in accordance with the said order, was held at ....and the said X acted as Chairman of the meeting.

9. The said X has reported the result of the meeting to this Hon'ble Court.

10. The said meeting was attended by (No. of members/creditors who attended in person/proxy) and the total value of their (debt/shares) is Rs....... The said Compromise or arrangement was read and explained by the said X to the meeting and it was resolved unanimously (or by majority of ....votes against ....votes as follows:

(Here set out the resolution passed)

11. The sanctioning of the Compromise or arrangement will be for the benefit of the Company.

12. Notice of this petition need not be served on any person.

The petitioner therefore prays:

1. That the said Compromise or arrangement may be sanctioned by the Court so as to be binding (members/creditors) of the said company and on the said Company.

2. Or such other order may be made in the premises as the court shall deem fit.

Verification etc. Petitioner.

Review Questions:

1. Explain the concept of merger and also state the different types of mergers.
2. State the reasons for merger or amalgamation with particular reference to changed economic scenario
3. State the legal steps to be followed by a company resorting to merger or amalgamation.
4. What are the points to be considered by the Board while drafting a scheme of merger or amalgamation?
5. State the differences between a meeting for considering a merger or amalgamation with any other General body meeting of the company.
6. Does the Court have any authority to reject or modify any scheme of merger or amalgamation as approved by the General body?
7. When can the Central Govt. order amalgamation of two or more Companies?

* * *

UNIT – 3

TAKEOVERS

This unit deals with another type of restructuring activity which is an off-shoot of Corporate Control, viz. Takeovers.

INTRODUCTION

We had emphasized in the previous units that maximization of value to the organization is the goal of any organization. To achieve this, the organizations resort to different methods. We had seen two of these methods merger and amalgamation which are more or less similar in nature. Now, we can see another method of restructuring which is becoming more popular and common in the present day economic scenario. This is commonly called as Takeover. In simple terms a take over is acquisition of voting rights in a Company with a view to gaining control over the management of the Company.

MEANING OF TAKEOVER

Takeover has been defined as a business transaction whereby an individual or a group of individuals of a Company acquire control over the assets of the Company, either directly by becoming the owner of those assets or indirectly by obtaining control of the management of the Company. This definition gives two possibilities for takeover. It can be either through acquisition of assets or gaining control of management. Of these two methods, it is the latter that is more common. It has been seen all over the world that takeover strategy is employed by different companies to improve the corporate value, productivity and profitability. What is the reason for this takeover? Why should a company become vulnerable to takeover?

The answer is that there are several factors which make a Company as the potential takeover candidate. Some of these include:

- Low Share price in relation to the replacement cost of the assets or their potential earning power.
- A highly liquid balance sheet with excess cash and significant unused debt capacity.

- Good cash flow vis-à-vis the current share price.
- There are properties which can be sold of without impeding cash flow.
- Small shareholding of the incumbent management.

These factors or a combination of them can make a firm an attractive investment opportunity and facilitate its financing. Thus the firm becomes a takeover candidate.

The person resorting to takeover can acquire the shares of the Company in a single transaction or in a series of transactions. While there is provision in the Companies Act 1956 for merger and amalgamation vide Sec.391-396, the concept of takeover is only regulated by some of the provisions of the Companies Act 1956, which we will explain in detail later and also the SEBI take over code and the listing agreement with the stock exchanges.

CONCEPT OF TAKEOVER

Take over as we have stated already is a method of gaining corporate control. The concept of corporate control is the most important aspect of any takeover. In the corporate world managers compete for rights to manage corporate resources. To accomplish this task they resort to either through the internal control mechanism (i.e. controlling the board) or through the external control through takeovers. The concept of takeover is not new in the world. But in India, where the economic policies were tight jacketed for a long time with licenses and approvals regime, takeovers were not easily possible. However, after the liberalization of the economic system in the 1990s, the whole attitude of corporate has undergone a vast change. It is not necessary for a corporate to now wait for a company to become sick and get rehabilitation before takeover. The changed business environment gives the corporate world the pre-emption for takeovers. In fact they can manipulate and even coerce through the back door to resort to takeover. The Securities Exchange Board of India (SEBI) has notified the Substantial Acquisition and Takeover Regulations in 1997 which laid down the procedure to be followed by an acquirer for acquiring shares and controlling interest in a Company. This is in itself signifies that there are lot of takeovers and there is almost a scramble for acquisitions.

OBJECTS OF TAKEOVER

There are many reasons for corporate to resort to takeover. One primary reason which we have already seen is the desire to gain corporate control. But this is not the only objective. There are many reasons to acquire corporate control. Some of them are illustrate below:

(a) **Diversification**: This is one of the objectives of takeover where the acquiring firm wants to diversify through new products and mitigate the risk that is involved in stepping out of Core competence areas.

(b) **Add value:** The other reason is to add value to shareholders by optimum utilization of resources.

(c) **Vertical combination**: Takeover also provides a vertical combination were by all stages in the manufacturing process of a product are carried on under one roof, thus saving in time, energy and also expenses.

(d) **Greater facilities**: To get substantial facilities for a larger company when compared to smaller companies, in areas like raising capital, purchase of raw materials and improving market share.

(e) **Savings:** The combined company saves in overheads and other working expenses on the strength of the combined resources and improves efficiency and profitability.

(f) **Development**: The combined entity gets a greater market share and enjoys strong presence and hence becomes a force to reckon with.

TYPES OF TAKEOVERS:

Takeovers can be classified as 1) Friendly Takeovers and 2) Hostile Takeovers.

In a Friendly takeover, the entire takeover exercise is done with the consent of the management of both the companies and also the approval of the shareholders of the target company. There is no coercion in such takeovers.

In a hostile take over, the acquiring company does not inform either the management or the shareholders of the target company, but silently and unilaterally pursues various ways and means to acquire the company forcibly. There have been many instances in the Indian corporate scenario of hostile

takeovers and takeover attempts. The acquisition of Shalimar Paints by Jindals, Pleasant

Hotels by Oberoi's, Ceat Tyres by Goenkas are some of the examples of successful takeover bids. There have also been instances as in the case of Swaraj Paul takeover attempt of Escorts were the hostile takeover attempt failed.

There is also another type of takeover known as **Bail out takeover** where a financially sick company is taken over by a profit making company. But this type of takeover is normally done only where the financial institutions have agreed to rehabilitate the company and a scheme of financial reconstruction has been drawn up in consultation with financial institutions.

LEGAL ASPECTS OF TAKEOVER

The legal support for takeovers is derived through various sources:

(a) Sec.372A of the Companies Act 1956 deals with acquisition of shares through a company. Similarly Sec.395 of the Companies Act 1956 lays down the procedure for transfer of undertaking to another Company, particularly in case of unlisted companies.

(b) Clause 40 A and 40 B of the listing agreement regulate takeovers. These clauses impose certain requirements of disclosure and advocate transparency.

(c) The SEBI (Substantial Acquisition of shares and takeovers) Regulations 1994 which were repealed by the new regulations issued on 20.02.1997 and amended subsequently regulate takeovers to a large extent.

We shall now look into the above legal procedures in detail.

TRANSFER OF UNDERTAKING TO ANOTHER COMPANY : (SEC.395)

Sec.395 of the Companies Act 1956 provides for another form of restructuring. This section does not require any judicial intervention unlike Sec.391. The essence of Sec.395 is that it enables a company to transfer its undertaking to another under a scheme involving an offer for purchase of shares and the majority of the shareholders of the transferor company have agreed to the offer. The procedure laid down by Sec.395 is as under:

(a) The Company proposing to takeover known as the transferee company is required to make an offer to the other company known as the transferor company whose shares it wants to acquire. If within **four months** of the offer, the proposal to acquire shares is approved by **nine-tenth value** of shareholders of the transferor company, the transferee company is entitled to acquire the shares of the shareholders of the transferor company including the **dissenting shareholders**.

(b) The transferee company may at any time within **two months after the expiry of four months**, can give notice to the dissenting shareholders that it desires to acquire their shares.

(c) The transferee Company can acquire the shares of the dissenting shareholders, unless the dissenting shareholders have moved the court **within one month** after the notice to acquire their shares was given by the transferee company.

(d) If the dissenting shareholders do not move the court or where the court has refused to intervene, then the transferee company shall proceed to acquire the shares of the dissenting shareholders on the same terms on which it had acquired the shares of the majority shareholders.

(e) Sec.395(3) provides that where the transferee company proceeds to acquire the shares of the dissenting shareholders after the expiry of the stipulated period stated above and there is no judicial intervention, it can serve a notice on the transferor company to acquire the shares of the dissenting shareholders along with an instrument of transfer duly executed by any person authorized in this behalf and also pay the consideration to the transferor company so that it can then be passed on to the dissenting shareholders.

(f) The transferor company thereafter can register the transferee company as the holder of those shares and within one month of such registration inform dissenting shareholders of the fact of registration and also receive the consideration on their behalf.

(g) Sec.395(4) stipulates that any sum received by the transferor company as per the said provisions shall be kept in a separate bank account and shall be held by the company in trust on behalf of the dissenting shareholders.

(h) The transferor company shall then pay the consideration to dissenting shareholders as and when they choose to receive the consideration.

(i) The important aspect to be noted is that wherever the object clause of the transferee company has a provision for takeover the company can resort to takeover straight away. The scheme should be discussed by the Board and if it is beneficial to the shareholders of the company then only it should be circulated to the shareholders. It must also be remembered that the Sec.395 does not specify that the approval should be obtained only in a General meeting. In fact approval obtained through any method is acceptable as long as it is approved by nine-tenth of the holders in value and 75% of the number of shareholders.

(j) The most advantageous aspect of this method of takeover is that there is no court intervention as such and even if some dissenting shareholders go to the court, the court will not examine the scheme as such but only see that the dissenting shareholders have been protected from the tyranny of the majority shareholders.

TAKEOVER OF LISTED COMPANIES

Takeover of listed companies whose securities are listed in one or more stock exchanges is governed by the provisions of the listing agreement of the stock exchange and the Securities Exchange Board of India (Substantial acquisition of shares and takeovers) Regulations 1997.

Initial attempts at takeovers was sought to be regulated in a limited way through Clause 40 of the listing agreement. But it was found that the persons/companies resorting to takeover used to circumvent this provision and the clause did not effectively serve the purpose. So the SEBI Substantial acquisition of shares and takeovers regulation 1997 was introduced to over come this lacuna. At the same time Clause 40 A and 40 B of the listing agreement were also amended to bring them in line with the takeover code.

The salient aspect of the provisions in Clause 40A of the listing agreement is that any company where its application for listing is granted by any stock exchange **shall maintain and continue to maintain the minimum level of promoter holding** at the level of public shareholding as required at the time of listing. In case it fails to do so, it shall buy back the public shareholding as

laid down by the SEBI (Substantial acquisition of shares and takeovers) Regulations 1997. The clause also provides that the company shall not make any preferential allotment or resort to buy back which has the effect of reducing the promoter holding to less than the public holding.

The Company also agrees as per the above listing agreement (Clause 40 A) that if any person acquires 5% of the voting rights of any securities or where any person acquires 15% of the voting rights of any securities or holds not less than 15% of the voting rights of any securities, he shall comply with the provisions given in the SEBI (Substantial acquisition of shares and takeovers) Regulations 1997.

Clause 40 B of the listing agreement stipulates that any company which has been listed on a stock exchange, receives any offer of takeover or if there is any change in management control, it shall comply with the SEBI (Substantial acquisition of shares and takeovers) Regulations 1997.

SEBI (Substantial acquisition of shares and takeovers) Regulations 1997

We shall now proceed to discuss the salient aspects of the above regulations of the SEBI which lay down the regulations for takeovers.

While it may not be possible to reproduce the entire regulations here, students are advised to refer to any book for the complete provisions of these regulations. We shall discuss in the following pages some of the important regulations of this takeover code.

DISCLOSURE OF SHAREHOLDING AND CONTROL

Regulation: 7 - Any acquirer (a person who acquires shares) or voting rights of more than 5% or 10% or 14% in a company in any manner shall disclose the same at every stage to the company as well as the stock exchange were the shares of the company are listed.

Where an acquirer along with **persons acting in concert** has already acquired 15% or more but less than 75% of the shares or voting rights as contemplated by Regulation 11, shall disclose purchase or sale of 2% or more of the capital of the company to the company as well as the stock exchange where the shares of the company are listed, within 2 days.

(**Persons acting in concert** shall mean persons who have a common objective of substantial acquisition and control and shall include a company, its directors, trustees of mutual funds, foreign institutional investors, merchant bankers, portfolio manager, venture fund sponsors, banks, brokers etc.)

Regulation:8- Every person holding more than 15% shares or voting rights , a promoter having control over a company, every company whose shares are listed on a stock exchange shall within 21days of the close of the financial year shall make yearly disclosures. The promoters and the company shall also make disclosures at the time of declaration of dividend. These disclosures pertain to their holding in the company and the extent control they have over the management of the company.

The Company in turn is required to inform the stock exchange where the shares of the company are listed, the details of changes if any in the case of bulk holders. This will enable the stock exchange to monitor the acquisitions and also ensure that the acquisitions have been made after complying with the Regulations.

SUBSTANTIAL ACQUISITION OF SHARES AND VOTING RIGHTS

Regulations 10, 11 AND 12: No acquirer shall acquire shares or voting rights in a company in excess of 15% or more unless he has made a public announcement to acquire shares of such company.

No acquirer along with the persons acting in concert who has acquired 15% or more but less than 75% of the shares or voting rights in a company shall acquire either by himself or with persons acting in concert additional shares or voting rights entitling him to exercise more than 5% of voting rights in any financial year unless the acquirer has made a public announcement.

No acquirer together with persons acting in concert who has acquired 75% of the shares or voting rights in a company shall acquire further additional shares or voting rights without making a public announcement.

An acquirer, who has made a public announcement as stipulated above, is not required to make further announcements, if he acquires further shares.

An acquirer is required to make a public announcement irrespective of whether or not there has been acquisition of shares earlier. However, any

change in control pursuance to a special resolution of the Company is not attracted by these provisions.

The sum and substance of the above Regulations 10,11 and 12 is that any acquisition made by any person shall be done only after a public announcement has been made. This is particularly so in respect of persons who already hold 15% or more but less than 75% of the shares or voting rights. It is enough if the announcement is made once. The announcement is necessary whether or not there is an acquisition earlier. However, where the control of the company is changed through a special resolution, these regulations will not be attracted.

PUBLIC ANNOUNCMENT AND ITS CONTENTS

Regulation 14: The public announcement shall be made by the Merchant banker appointed by the acquirer. The announcement shall be made by the merchant banker **not later than four working days of entering into an agreement for acquisition** of shares or voting rights as specified in Regulations 10 or 11. In case of disinvestment of PSU, the announcement shall be made **not later than 4 working days of executing the share purchase agreement with the central or state government.** If any acquisition of GDRs or ADRs is made which has the effect attracting Regulations 10 or 11 supra, then also a public announcement shall be made in the above manner. However in case of indirect acquisition or control, public announcement shall be made by the acquirer within 3 months of consummation or restructuring.

Regulation 15: The public announcement stated in Regulations 10,11 and 12 shall be made in one English daily, one Hindi daily and one Regional language daily widely circulated in the place where the Registered office of the company is situated and at the place of the stock exchange where the shares of the company are frequently traded. The public announcement shall be also submitted to the Board, to all the stock exchanges and also to the target Company.

Regulation 16: The public announcement shall contain the following particulars:

a) the paid up share capital of the company and the no of shares.

b) the number and percentage of shares proposed to be acquired.

c) the minimum offer price and the mode of payment of consideration.

d) the identity of the acquirer and the promoters

e) the highest average price paid by the acquirer during the last twelve months.

f) the salient features of the agreement and the object and reasons for the acquisition.

g) the date of opening and closing of the offer.

MINIMUM OF NO OF SHARES TO BE ACQUIRED

Regulation 21: The public offer shall be for a minimum of 20% of the voting capital of the company. If the public offer results in public shareholding being reduced to 10% or less of voting capital the acquirer shall either make an offer to buy the outstanding shares remaining with the shareholders or undertake to disinvest through an offer for sale or by fresh issue of capital to the public.

PROCEDURE FOR TAKEOVERS

The procedure for takeover which involves an offer to the shareholders of the target company to acquire their shares should be done by the acquirer through the merchant banker with the consent of the board of directors of the target company. The SEBI (Substantial acquisition of shares and takeovers) Regulations 1997 stipulate the procedure to be followed for the acquisition. The procedure is given in nutshell. Students are advised to go through above regulations and familiarize themselves with the procedure.

The procedure involves the following steps:

a) The acquirer has to file with the SEBI the draft letter of the offer with all disclosures as required through the merchant banker within 14 days from the date of public announcement.

b) The merchant banker shall ensure that the acquirer will implement the offer, make firm arrangement of funds through verifiable means and also furnish a due diligence certificate to the SEBI along with the letter of offer.

c) The letter of offer is required to be sent to the shareholders (including the custodians of GDRs and ADRS) not earlier than 21 days before its submission to the SEBI. The public announcement shall specify a date which is called the specified date for the purpose of determining the names of the shareholders to whom the letter of offer is to be sent. It cannot be later than thirtieth day from the date of public announcement.

d) The date of opening of the offer cannot be later than the 60th day from the date of public announcement and is to be kept open for 30 days.

e) The Board of directors of the target company shall within 7 days from the specified date furnish to the acquirer a list of shareholders who are eligible to participate in the offer along with relevant details.

f) It is obligatory on the part of the Board of directors of the target company that they should not make any appointment on the board either as additional directors or even fill a casual vacancy once the public announcement is made.

g) The directors are required to send their comments and recommendations to the shareholders taking into account their fiduciary responsibility lest they will become liable for any concealment of material information or misstatement.

h) During the offer period neither the acquirer nor his nominees can be appointed on the board. The acquirer shall not acquire any shares in the company during the offer period.

i) The acquirer through the merchant banker shall make arrangements to open an **ESCROW Account** on or before the date of public announcement.

j) The escrow amount is to be calculated with reference to consideration taking into account highest offer price. The escrow account shall consist of cash deposited with schedule commercial bank, bank guarantee in favour of merchant banker and deposit of acceptable securities. In respect of bank guarantee and deposit of acceptable securities, the merchant banker shall be authorized to realize the same.

k) The escrow account shall be released in the following manner:

- the entire amount upon withdrawal of the offer on certification by merchant banker.

- Transfer 90% of the amount in the escrow account to a special fund for distribution to the shareholders. The balance of 10% shall be transferred to the acquirer on completion of all formalities on certification by merchant banker

- the entire amount in the escrow account will be transferred to the merchant banker in the event of forfeiture for non-fulfillment of any obligations for distribution of 1/3 rd of the amount each to the target company, regional stock exchange and to the shareholders who have accepted the offer.

l) The acquirer has to complete all procedure relating to the offer including payment of consideration within a period of 30 days from the close of the offer and this period can be extended for further 30 days on valid grounds. If the offer is withdrawn, the acquirer shall not make any offer for six months. If the obligation is not fulfilled, the acquirer shall not make any offer for 12 months.

m) The merchant banker is required to send a report to the board within 45 days from the date of closure of the offer.

n) The board directors of the target company is required to facilitate transfer of securities in the name of acquirer upon fulfillment all obligations by him.

o) The acquirer who has acquired control over the target company shall be debarred from disposing off or encumbering its assets for a period of two years from the date of close of the public offer.

COMPETITIVE BIDDING

Any person other than the acquirer who has made a public announcement, who desires to make an offer, shall make a public announcement within 21 days of the public announcement of the first offer. The competitive bid made shall be for such number of shares, which along with the shares already held by him and also by the persons acting in concert with him, shall be for not less than the number of shares for which the first offer was made.

The first acquirer shall then have the option to revise his offer or withdraw the same and this option shall be exercised within 14 days of the competitive bidding. Both the first acquirer and the competitive bidder shall have the option to revise their offers in respect of both price and number of shares up to seven working days prior to the date of closure of the offer. The last subsisting competitive bid alone will be considered. The value of escrow account should also be increased accordingly. All relevant details regarding the bidding shall be communicated to the SEBI and shareholders as was done in the case of the first public announcement.

PAYMENT OF CONSIDERATION

The payment of consideration shall be made in accordance with Regulation 29. The SEBI takeover code 1997, casts an obligation on the acquirer to open a separate bank account. This is to avoid delay in payment of consideration. The full amount of consideration is to be deposited in this account within 21 days from the date of closure of the offer. 90% of the amount in the escrow account along with such amount which will make up the entire amount payable as consideration to the shareholders shall be deposited in the separate account.

The payment of consideration and mode of payment has been standardized in the same manner as the refund account procedure for primary issues.

Any unclaimed amount from the separate account shall be kept there for a minimum period of 3 years and thereafter the unclaimed balance if any shall be transferred to the investor protection fund of the regional stock exchange of the target company. In respect of consideration payable by way of exchange of securities, the acquirer shall ensure that the securities are actually issued and sent to the shareholder.

ECONOMIC ASPECTS OF TAKEOVER

We have so far seen that takeover exercise is primarily aimed at gaining control of management of a company which has financial value and is capable of

delivering returns at a rapid pace. In fact any acquisition is aimed at maximising corporate value, increase productivity and profitability.

An acquirer of a company has the option to run the acquired company as a separate entity or resort to merger or amalgamation with another company. In both the cases the objective is better management of resources, increasing value to the shareholders, betterment of the economic condition of the employees and serve the ultimate consumer in a more efficient and effective way. If there is better management on take over, it is not the company alone that benefit, but also the different stakeholders stand to gain in the changed economic environment of the company.

Takeovers are also beneficial to the economy in that they bring orderliness to the stock market by virtually eliminating ill managed and incompetent companies and the acquired company is able to display its full potential. It is common knowledge that in the earlier years when the system of licensing was in vogue, many companies which were granted licenses were not able to achieve the specified capacities due to competition from bigger and efficient companies. The fragmented small companies were not in a position to consolidate their infrastructure and there by their developments were impeded to a great extent. Takeovers have helped in consolidation of these fragmented units and in some cases it has helped to even revive sick units. Before liberalization diversification and even expansion was inhibited due to restrictive policies and in turn it retarded the growth of companies. Takeovers apart from providing consolidation also enable the companies to diversify by focusing on their core competency and thereby enhance their value and leverage their capability.

FINANCIAL ASPECTS OF TAKEOVERS

Financial leverage for the company is also a key reason for takeover. Takeovers not only have the potential to increase the financial leverage for the company but also to the different stakeholders including the employees, creditors and shareholders. But from the perspective of the acquirer, any investment made in shares will have to be accounted for in his personal account. However, if the acquisition is made by a company, then the amount invested will be accounted in the books of the acquiring company, which will be treated as a Holding company. Moreover, the acquiring company shall maintain a Register of investments as required under Sec.372 A of the Companies Act 1956.

BAILOUT TAKEOVER

SEBI (Substantial acquisition of shares and takeovers) Regulations 1997 provide for takeover of **financially weak but not sick companies,** where a scheme of rehabilitation has been approved by a public financial institution or scheduled bank. A Financially weak company means a company which has at the end of the previous financial year accumulated losses, which has resulted in erosion of more than 50% but less than 100% of its net worth as at the beginning of the previous financial year.

The public financial institution or the Scheduled bank as the case may be has to apprise the financially weak company after taking into account the financial viability and also determine the funds required for its revival. In doing so, it should be kept in mind that any scheme for revival should protect the shareholders particularly the minority shareholders, should usher in good management and everything done in this regard shall be transparent. If it is necessary the revival can also include a change in management.

Regulation 30 of the SEBI Regulations 1997 provides for acquisition of shares in a financially weak company either through outright purchase of shares or exchange of shares or both. The financial institution can invite offers for acquisition of shares from at least three parties. The bids to bailout the weak company can be evaluated, and the party to acquire the company can be selected taking into account financial capability, managerial ability and technical soundness. The person selected to acquire the shares make an offer to the promoters, shareholders and others to acquire their shares at a mutually agreed price. Thus the provisions of this regulation help to bail out a financially weak but not sick company from its financial mess.

TAKEOVER OF SICK UNITS

We have seen above that financially weak but not sick companies can be taken over via SEBI Regulations 1997. However, in respect of sick companies the State Financial Corporation Act 1951 provides for takeovers. But this provision is limited in scope as it applies only to those companies that have borrowed from the corporation. Therefore it is obligatory on the part of a sick company to revived first through any financial institution and then only it can be taken over. The SFC act gives to the Corporation the option of acquiring a

company which is not able to meet its financial obligation. This means that the company is financially bankrupt in that it has defaulted in repayment of loans to the institution. In such a scenario the State Financial Corporation has the option to acquire the company or institute proceedings against the company for recovery of the loan. But it cannot do both simultaneously. Where it decides to acquire the company, it can take over the management of the company as well as possession of the assets of the company. In this way it can better manage the company, revive the company and either bring it back on rails or ensure that the company is liquidated in accordance with the relevant provisions.

Review Questions:

1. List the reasons which you think make a company as a potential takeover candidate.
2. Takeovers in India are slow but are gathering momentum – Discuss this statement with reference to the takeover scenario in India.
3. State the provisions of different regulations which regulate the takeover of listed companies.
4. Acquiring the shares of the minority shareholders has to be done cautiously. Amplify this statement with reference to the relevant provisions in the Companies Act 1956.
5. An acquirer has to weigh his options before takeover. Analyse this statement with respect to the objects of takeover.
6. State the benefits that accrue to the economy on account of a takeover.
7. What is a bailout takeover? When it can be resorted to?

* * *

UNIT – 4

CORPORATE DEMERGERS / SPLITS &DIVISIONS AND POST MERGER REORGANISATION

WHAT IS DEMERGER?

Demerger simply means split or division of a company. It is a method of splitting the company or dividing the company or divesting the company. The Companies Act 1956 does not define demerger. In fact it is not easy to define this term. All types of activity like leveraged buy outs, spin-offs, employee stock option plans, split ups and split offs etc can be bracketed within this demerger. The word **arrangement** in Sec.390 of the Companies Act being more wider in meaning can encompass the term demerger in its ambit. The most important reason for demerger is the family disputes resulting in dividing or divesting a portion of the company. The most recent example in this category is the demerger of Reliance Industries consequent to a dispute between the Ambani brothers.

Demerger has however been defined in the Income Tax Act 1961. We shall reproduce that definition here in order to have clarity of this mode of restructuring.

Sec.21 (19AA) of the Income tax Act 1961 defines demerger as follows:

"demerger" in relation to companies means the transfer pursuant to a scheme of arrangement under Sec.391 to 394 of the Companies Act 1956 by a demerged company of its one or more undertakings to any resulting company in such manner that:

i) all the property of the undertaking being transferred by the demerged company, immediately before the demerger, becomes the property of the resulting company by virtue of the demerger;

ii) all the liabilities relating to the undertaking, being transferred by the demerged company, immediately before the demerger, become the liabilities of the resulting company by virtue of the demerger;

iii) the property and liabilities of the undertaking or undertakings being transferred by the demerged company are transferred at values appearing in the books of account immediately before the demerger;

iv) the resulting company issues, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportionate basis;

v) the shareholders holding not less than three-fourths in value of shares of the demerged company (other than shares already held therein immediately before the demerger, or by a nominee for, the resulting company or, its subsidiary) become shareholders of the resulting company or companies by virtue of the demerger, otherwise than as a result of the acquisition of the property or assets of the demerged company or any undertaking thereof by the resulting company;

vi) the transfer of the undertaking is on a going concern basis;

vii) the demerger is in accordance with the conditions, if any, notified under the sub-section (5) of Sec.72A by the Central Govt. in this behalf.

From the above definition, certain points emerge. The first is the word "undertaking" means and include any unit or division or even a business activity. So the demerged entity can even be a unit or division or business activity of the company. The second aspect that stands out in this scheme of restructuring is that demerger is essentially an arrangement requiring approval by three-fourths in value of shareholders for demerging the company. The resulting company concept brought out by the definition signifies that the transfer can be only through issue of shares and any consideration involved shall be paid only to the shareholders of the demerged company.

Based on the above, it is clear that the concept of demerger involves splitting or carving out a new entity, through consideration paid to the shareholders of the demerged company and it is essentially an arrangement.

TYPES OF DEMERGER

Demergers can be classified into different types based on the type of arrangement that is made by the demerged company with the resulting company. They can be:

(a) **Divestitures:** This is a restructuring activity wherein a segment of a company is sold to a third party either for cash or for securities. The main reason for this type of demerger is that any organization wants the entire entity to be homogeneous for effective control and management and so any segment or division which does not fit into the homogeneity is divested.

(b) **Spin Off:** This type of restructuring is more associated with controlled subsidiaries. In a spin off, a company distributes on a pro rata basis all the shares it owns in a subsidiary to its own shareholders. Two companies with the same proportional equity now exist where one exited before.

(c) **Split Off**: Split off is a reorganization of controlling interest. In this type of restructuring, share holders of the parent company get shares in the subsidiary company in exchange for shares in the parent company. In this method, only those shareholders, who relinquish their shares in the parent company alone, get the shares in the subsidiary and not all shareholders.

(d) **Split up:** In this method all the subsidiaries of a company are spin off and the parent company ceases to exist. It is a method of selling the company as different fragments in such a way the original parent no longer exist.

(e) **Equity carved out**: This is an initial public offering of some portion of the shares of wholly owned subsidiary and thus the company is divided into two or more entities. The most important aspect of this type of restructuring is that the parent company maintains control over the subsidiary which means only a minority interest is sold out.

DEMERGER AND RECONSTRUCTION: DISTINCTION

We have seen in the preceding paragraphs as to what constitute **demerger**. The sum and substance of the concept is that it is essentially an arrangement of divesting, spinning off or splitting etc of an undertaking with a view to form new and separate companies. Sec.391 to Sec.394 of the Companies Act 1956 provides for a scheme of arrangement. The arrangement envisaged provides interalia, for formation of new company known as the resulting company, transfer of assets and liabilities of the demerged entity to the

resulting company, issue of shares by the resulting company to shareholders of the demerged company as consideration and most importantly the transfer of the undertaking is done on a going basis. It means that in a demerger exercise an arrangement is worked out where by a portion of the entity or a division or a business activity is hived off into new company or companies for a consideration to be paid to the shareholders of the demerged company. The entire arrangement is carried on without in any way affecting the **continuity of the business** of either the demerged company or the hived off entities as resulting company or companies. More than all this the scheme of demerger has legal sanction and the court also is required to put its stamp of approval, thereby making entire exercise beyond legal doubt or scrutiny.

Reconstruction on the other hand is the transfer of undertaking or business of one company to one or more other companies formed specifically for the purpose. The new company may have the same shareholders or substantially the same shareholders. The existing company goes into liquidation and the shareholders instead of being paid the capital as is usually the case are given shares in the new company or companies. The result is that the same shareholders carry on the business of the company in a new name and from scratch. The new company may have different capital structure or different objects or may be incorporated in a different country but the members of the new company are substantially the same as that of the old company.

It is inferred from the above that in a reconstruction the existing company is dissolved and the new company starts from scratch may be with different objects, with different capital structure or in a new country or even in a new name. It takes over the assets and liabilities of the existing company and also virtually the same shareholders. Sec.394 of the Companies Act 1956 refers to this term without defining it. The concept of reconstruction is more suited where the existing company is to be liquidated and the new company to be formed is to have different object or is incorporated in a different country but in a scheme of demerger the business of neither the demerged company nor the resulting company is disrupted in any manner. So in effect a demerger is an event in the annals of the company whereas reconstruction transforms the company and the new entity may have new business or may be started in a new area or even with new capital structure. But the only thing that remains the same is the substantial number of shareholders.

MODES OF DEMERGER

Basically demerger can be partial or complete demerger. In the partial demerger, divisions or units of the existing company are demerged into new company or companies and the shareholders of the demerged company are allotted shares in the new companies as per the agreed ratio. The existing company which has demerged also continues to co-exist with the new companies after demerger and carries on business as a separate legal entity. In a complete demerger on the other hand, a company is divided or demerged into new companies and the existing company is dissolved by a special resolution as in the case of voluntary winding up. This means in a complete demerger the demerged company ceases to carry on business and no longer exist as an entity.

Demerger of a company can take place in three ways:

1) Demerger by agreement between promoters.
2) Demerger under a scheme of arrangement with approval by the court under Sec.391 and
3) Demerger under voluntary winding up.

Demerger by Agreement

This is the simplest form of demerger. It is resorted to by agreement. The agreement can be between the promoters of the company or even the shareholders of the company. It may be possible for the promoters of the company to enter into an agreement for dividing the company. As stated earlier, demerger's being primarily family arrangements, the promoters of the company can agree to divide the company and dissolve the company and share the assets after paying off the liabilities. Another possibility is that a company which has been divided or demerged can be wound up after the shareholders of the company have passed a special resolution for voluntary liquidation of the company. In either scenario, all the property and liabilities of the demerged company are transferred to the resulting company. The resulting company in turn issue shares to the shareholders of the demerged company in the agreed proportion as consideration for demerger.

Demerger under a Scheme of Arrangement

We have stated earlier that demerger is basically a scheme of arrangement between the shareholders of the company to divest or split or spin off the company. As in the case of an arrangement for merger or amalgamation, a scheme of demerger can also be drawn under Sec.391 of the Companies Act 1956 and the approval of the court for the scheme can be obtained. The salient features of this mode of demerger are that:

- The Memorandum of Association of the Company shall have a provision for demerger by divesting or splitting the company.
- There should be an agreement between the Company and its members regarding demerger and the scheme shall be drawn accordingly.
- An application must be made to the Court by the Company or members or creditors as the case may be for a direction in this regard.
- The Court may order meetings of members or creditors as may be the case.
- The meetings of the creditors and members shall be held as per the court directive.
- The scheme of demerger should be approved by three-fourths in value of creditors or members.
- The Court shall then sanction the scheme of demerger. The scheme sanctioned by the Court shall be binding all concerned viz. the members, creditors as the case may be.
- The Court's order shall have effect only after a certified copy has been filed with the Registrar of Companies.

PROCEDURE UNDER A SCHEME OF DEMERGER

The procedure for a scheme of demerger is the same as in the case of amalgamation or merger. Therefore, the provisions of Sec.391 to Sec.394 and the procedure laid down therein as applicable to the scheme of merger or amalgamation will apply **mutatis-mutandis** to the scheme of demerger of a Company. **(Students are advised to refer to the procedures laid down in**

Unit: 2 on Mergers and Amalgamations and apply the same here accordingly)

However, a scheme of demerger as an arrangement requires the following additional aspects which should also find a place in the scheme.

1) The basis of allocation of shares in the resulting company to the members of the demerged company.

2) The directors of the transferor company and the transferee Companies shall report to the meeting of members as to whether there are any material changes in the property and liabilities of the transferor Company between the dates of when the scheme was drafted to the date of the meeting of members.

3) The scheme of demerger is required to be approved by the Board of directors of both the demerged Company and the resulting Company.

4) The application to the Court under Sec.391 shall be made by both the Companies separately to the respective High Courts as applicable.

5) The Companies are required to hold separate General meetings and report back to the Court. Any modifications in the scheme should also be carried out by both the Companies.

6) The order of the Court shall be binding on both the Companies and will take effect after a certified copy has been filed with the Registrar of Companies by both the Companies.

Demerger by Voluntary Winding up

We had seen earlier that demerger can be either partial or complete. In a partial demerger the demerged Company continues to exist as a separate legal entity and carries on business in the usual way. In a complete demerger the Company is divided or split and divested with the result the demerged Company cannot exist as an entity and in such cases it is dissolved through the mode of voluntary winding up by passing a Special resolution by the shareholders of the Company.

Sec.484 of the Companies Act 1956 stipulates that a Company can be voluntarily wound up if the Company passes a Special resolution to that effect or wherever the articles have fixed duration for the Company and the same has expired, it can wound up by passing an ordinary resolution.

Sec.494 provides that where a Company (demerged company) is in the course of being wound up and it has been decided to transfer or sell the whole or part of the undertaking to another company (resulting Company), the liquidator of the transferor company can with the consent of the members by a Special resolution transfer the assets and liabilities of the demerged company to the resulting company for consideration as may be arrived at as a part of the overall arrangement. The demerged company is then dissolved and ceases to exist.

TAX ASPECTS OF DEMERGERS

Corporate Restructuring is a recent concept. The tax laws of this country did not provide hitherto any provisions for reorganization or restructuring. In the changed economic scenario with a plethora of avenues for restructuring in the form of mergers, demergers, amalgamation and reconstruction, it has become imperative to rationalize the tax aspects in this regard. The Finance Act 1999 effected certain changes in the tax provision which have become effective since 01.04.2000. The basic reason is that the companies which resort to restructuring should not be burdened by the act through the taxman. The sum and substance of this is that any demerger activity **should be tax neutral**. The concessions and facilities that were made available to the demerged company should also be available to the resulting company. The accumulated losses, if any, of the demerged company should be allowed to be carried forward by the resulting company if these losses pertain to the business demerged. Any benefit that is bestowed on these companies should be in relation to the transfer of business only. These aspects are taken care of by the Finance Act referred above. While the last word has not been said on rationalization of tax laws with regard to the restructuring activity, it is necessary that any change or rationalization that is proposed should be to encourage the restructuring activities and at the same time serve as a deterrent to any corporate who wants to resort to this route for tax evasion.

TAX RELIEFS

Tax relief is provided both to the demerged company and the resulting company. Various reliefs have been provided to the companies under the Income Tax Act 1961. While it may not be possible to discuss every one of them in detail, a gist of the reliefs available are given below. It is better for the students to refer to the Income tax provisions for detailed information.

We can divide the reliefs available into those that are available to the demerged company and its shareholders and those that are available to the resulting company. **The tax sops available to the demerged company are:**

a) **Capital Gains tax**: This is a tax on capital gain leviable on transfer of capital asset. Sec.47 (vib) and (vic) of the Income Tax Act 1961 provides that any transfer of capital assets in a demerger by the demerged company to the resulting company will not be regarded as 'transfer' within the meaning Sec.2(47) of the Income tax Act 1961 and consequently will not attract capital gains tax. In case of foreign company, the above provisions will apply but subject to the conditions that at least 75% of the shareholders of the demerged foreign company also hold shares in the resulting company and the transfer does not attract capital gains tax in the country in which the foreign company was incorporated.

Similarly Sec.47 (vid) of the Income tax Act 1961 exempts the issue of shares by the resulting company to the shareholders of demerged company from the purview of Capital gains tax for the shareholders.

b) **Set off and carry forward accumulated losses and unabsorbed depreciation:** The accumulated losses and the unabsorbed depreciation, which is directly attributable to the units transferred to the resulting company, will be allowed to be carried forward and set off in the hands of the resulting company. If the accumulated losses and the unabsorbed depreciation are not directly related to the transferred undertaking, they will be apportioned between the demerged company and the resulting company in the same proportion in which the assets have been divided and will be allowed to be carried forward and set off by these companies.

The tax reliefs to the resulting company will be available only if the resulting company is an Indian company and some of them are as under:

a) **Depreciation on assets transferred to the resulting company**: The assets transferred to the resulting company will continue to be eligible for depreciation under Sec.32 of the Income tax Act 1961 subject however to the condition that it shall not exceed the depreciation that would have been deducted had the demerger not taken place.

b) **Expenditure on acquisition of Patents and Copy rights:** In terms of Sec.35A of the Income tax Act 1961, if the demerged company had purchased Patent rights or copy rights, the resulting company on demerger will be entitle to claim a deduction on the unexpired instalments (Total instalments 14).

c) **c) Expenditure on know-how**: The resulting company is entitled to claim a deduction for expenditure incurred in acquiring know-how to the extent of the residual period, if it had been available to the demerged company before the demerger. (Sec.35AB (3))

d) **Expenditure on obtaining a license to operate telecommunication services**: Any expenditure on license for telecom services allowed as a deduction to the demerged company will also be available to the resulting company for the residual period in terms of Sec.35ABB of the Act.

e) **Amortisation of Preliminary expenses**: This benefit is basically available for 10 years to the assessee who incurred the expenditure (Sec.35D). But this deduction can also be claimed by the resulting company for the unexpired period in the event of demerger.

f) **Expenditure on Scientific research:** In case of demerger if any assets on which expenditure on scientific research has been incurred by the demerged company and the asset is transferred to the resulting company, then the resulting is also entitled to claim the deduction.

The Finance Act 1999 introduced a provision vide Sec.41(1) (4) that the resulting company in case of a demerger shall for all practical purpose shall be a successor in business of the demerged company and consequently will enjoy all the benefits of exemptions and deductions that were hitherto available to the demerged company. The above exemptions and deductions which we have stated amplify this provision.

REVERSE MERGER

Merger and amalgamation are methods of restructuring that are commonly resorted to by companies. It is the normal practice that in case of merger or amalgamation the loss making or the less profit making company merges with a more financially healthy company. A Reverse merger takes place

when a financially healthy company merges with a financially weak company. This results in the healthy company being extinguished and the weak company getting revived. In terms of the Companies Act 1956, there is no difference whatsoever between a merger and a reverse merger. In fact both are governed by the provisions of Sec.391 to Sec.394 of the Companies Act 1956. The entire exercise in both the cases is carried out through a scheme sanctioned by the High Court after the approval by the shareholders of the companies.

The reason for the reverse merger mode of restructuring is primarily to avail the benefits that are conferred by Sec.72A of the Income tax Act 1961. When a sick company merges with a healthy company, the accumulated losses and unabsorbed depreciation of the sick company can be carried forward by the healthy company and set off in subsequent years. It is primarily to avail this benefit companies resort to reverse merger.

While the procedure for reverse merger is the same as in the case of merger, it is pertinent to note that in case of reverse merger of a healthy company with a sick industrial company attracting the provisions of the Sick Industrial Companies Act 2001, then the reverse merger has to take place under the aegis of BIFR and these provisions of the SICA will have overriding effect to that of the provisions of the Companies Act 1956. This is so because Sec.32 of the SICA has given very wide powers to the BIFR and thus BIFR can make different provisions contrary to those given in the Companies Act 1956.

Review Questions:

1. Explain the concept of demerger with reference to its definition.
2. Explain the different types of demerger and bring out the distinguishing features in them.
3. Demerger under a scheme of arrangement is similar to a merger or amalgamation - Do your agree with this statement and if so bring out the similarities in both the forms of restructuring.
4. What is Reverse merger? Does it differ from merger and if so how?
5. Tax reliefs provided by the Income tax Act 1961 are really an impetus to resort to demerger – Do you agree?
6. What is reconstruction? How does it differ from demerger?
7. In the merger of a sick company, the decision of BIFR is supreme? Do you agree?

* * *

UNIT – 5
POST MEREGER RE-ORGANISATION

INTRODUCTION

We had seen and elaborated that Restructuring resorted to by many organizations is only to redefine themselves and increase growth and profitability. To achieve this, organizations resort to various forms of restructuring like mergers, amalgamations, takeovers, divestitures, spin offs etc. Whatever may be the mode, the aim is fairly simple, enhance growth and improve profitability. Any organization broadly hinges its functioning on three basic parameters viz. managerial, financial and organizational. Each one is important for the organization and they all co-exist to make the organization more vibrant and more efficient in the corporate world. When a company decides that it should restructure itself, it does so with the sole aim of rejuvenating itself and resort to restructuring through any of the methods we have discussed in preceding units. That being the case, once the restructuring is complete, the organization has to evaluate the gains that have accrued consequent to the restructuring.

Post Merger reorganization is not confined to restructuring by mergers alone. It applies to all forms of restructuring including demerger, takeover etc. Post merger reorganization has been discussed in this unit with reference to all the forms restructuring which we have stated earlier. Post merger reorganization is the most difficult task for any company. It has to look into each and every aspect of the company's functional areas and analyse the extent of value the organization has derived in the post restructuring scenario.

ACCOMPLISHEMENT OF OBJECTIVES

Restructuring is resorted to only with the aim to attain certain objectives. To what extent these objectives have been accomplished is the most important aspect of post merger reorganization. It may be recalled that we have discussed in unit:1 of this study that any organization wants to restructure itself, because there is an urgent need which stem from the following reasons:

a) To focus on the strengths of the organization.

b) To allocate managerial capabilities and infrastructure efficiently.

c) To consolidate economy of scale.

d) To exploit domestic and global markets and

e) To improve corporate performance and survive competition.

The key objectives as can be seen are utilizing the strength of the organization to consolidate, exploit and improve corporate performance and also face the challenge of competition both domestically and globally by improving the managerial capabilities and utilizing the infrastructure efficiently. In a post merger scenario, it is imperative to take stock of what has happened and how it has benefited the organization. At the same time, the organization must analyse the short comings of the entire exercise.

If two entities merge or whenever there is restructuring in any form there are two key elements that are sought to be accomplished. Firstly the economies of scale get enlarged due to the coming together of two entities. Even in a demerger, there are benefits of economies of scale even though the organization is only downsized. Secondly managerial synergy also plays a very important role in a post merger scenario because it is generally believed that the coming together of the two entities gives to the organization superior managerial skills. Therefore it is pertinent to note that after restructuring the organization must evaluate the following aspects and see for itself to what extent it has accomplished the objectives that were set before restructuring.

a) The impact of integration on the key indicators of business performance.

b) The issues that have emerged during integration which required attention.

c) The financial outcome of the entire integration exercise.

d) The impact of integration on other organizational indicators such as the employees, customers and shareholders.

The in-depth analysis of these aspects alone will indicate whether or not the organization has succeeded in accomplishing its objectives.

CRITERIA FOR SUCCESS

Any merger or for that matter any mode of restructuring is primarily aimed at maximising gains through organizational, financial and managerial synergies. Every organization which resorts to restructuring wants to succeed in its endeavour. The success of one organization cannot be a precedent for another, as organizations differ in products, managerial efficiency, organizational behaviour and most importantly the timing of the restructuring activity. Success in the restructuring endeavour will depend on how the organization is able to gel all these aspects.

Peter F. Drucker, the management guru stated in an article of The **Wall Street Journal in 1981,** the famous five rules for successful mergers. He argues that any economically sensible merger must follow these rules. The five commandments of Drucker are:

i) Acquirer must contribute something to the acquired company.

ii) A common core of unit is required.

iii) Acquirer must respect the business of the acquired company.

iv) Within a year or so, acquiring company must be able to provide top management to the acquired company.

v) Within the first year of merger, management in both companies should receive promotion across entities.

These five rules for success of merger activity highlighted by Drucker essentially underlines one important attribute which the merged entity should have. That is the merger should not be only in name or integration of entities but should strive to drive a common bond between the different stake holders of the acquired company and the acquiring company. While any criteria of success attributed to individual organizations will not have a general validity, the core consideration will be the meeting of the minds and hearts of the different stake holders of both the entities. This will definitely bring the desired results.

In short, what is the deriving force for any restructuring activity? Why do firms merge or why there is takeover? The above principles of Drucker enunciate some key hypothesis. Firms restructure only if there are **no alternative investment opportunities** or the **relative cost of merger is cheaper** to internal expansion. Restructuring is also done to **avoid bankruptcy** or to

maintain financial stringency. Peter F. Drucker emphasizes that these can be achieved only if there **is relatedness and reward.** This means that for any restructuring activity to succeed the entities must be related to one another and the reward for merger should be substantial to the management. Companies which are related to one another have a greater chance of success. If the entities are complementary then also success can be achieved. For example a company strong in research but weak in marketing can combine with a company weak in research but strong in marketing.

These two aspects **relatedness and complementarities** will apply to all management functions and hence are the most important factors for success. Thus in essence for any restructuring activity to succeed - there should be relatedness and rewards. Combining two entities involves substantial trauma. So the rewards should be commensurate to heal the wounds. This alone will ensure success of the restructuring activity.

PROFITABILITY OF MERGERS

Profitability is a key driver in any restructuring activity. A firm merges with another only to maximize its growth and thereby the profit. Each firm has its goals. It plans to achieve these goals through various strategies. One of them is restructuring. The firms want to utilize its resources and capabilities to maximize its gains. This is not a static process. It is to be performed iteratively as the firm's capabilities and environment in which it functions constantly changes. Firms are not defined by their products but by their capabilities. This naturally creates both opportunities and threats. The firm which best utilizes the opportunities and wards off the threats alone will succeed. The merger activity allows the firm to acquire the desired capabilities if they are not there in a changed environment so that the ultimate aim of maximizing growth and profitability is achieved. Even where merger is only to enhance managerial capability, then also it leverages the profitability of the company.

Let us analyse an example in the corporate world. Nicholas Piramal was incorporated in 1988. Boheringer Mannhein India ltd, Rhone-Poulene India ltd, Super Pharma ltd merged with the company during 1997 and 2001. The company which was ranked at 48 during 1988 moved to 4th position in 14 years. These mergers gave the company the vitality and growth and consequently maximized its profit.

. Therefore profitability is the criteria for merger or for that matter any mode of restructuring. Evidences have shown that merger activity in most cases brings growth and profitability. Studies have revealed that any restructuring activity creates value. Profitability of the merged entity depends to a large extent on the GNP Growth and the investment opportunities that are available to the company. Once a merger takes place, there is definitely a financial leverage and depending upon the organizational effectiveness profitability also increases. It is up to the reorganized firm to effectively bring in ideological bond between the different stakeholders and thereby leverage the functioning of the merged entity in all aspects so that the ultimate goal of maximizing growth and profitability can be easily achieved.

GAINS TO POST MERGER VALUATION

Post Merger any firm stands to gain in different ways. The gains will be substantial if the merger has been planned and organized with care and acumen. We will discuss some of the gains that accrue to the organization in a post merger scenario.

(a) a) **Efficiency**: The merged entity becomes more efficient. The efficiency of different firms differs due to several factors. In a merger context an efficient firm merging with a not so efficient firm, the level of efficiency of the inefficient firm is spiked up and brought on par with the efficient firm. This may only be a social gain but has the potential of increasing the value of the organization. The growth of an efficient firm is far greater than that of a firm which is inefficient. It is to be noted that inefficiency of the firm is patently derived from the inefficiency of the management. The merger of firms different in efficiency would goad the inefficient management to improve performance and match the efficiency. This is a great value to the organization post merger.

(b) **Operating Synergy:** This is another gain in the post merger context. Merger of firms also brings with it the increased economies of scale. The merged entity has benefits of better utilization of capacity, better deployment of personnel resulting in better growth and save on avoidable cost like bargaining etc. It is pertinent to note here that integration of firms which are in the different stages of an industry brings better operational synergy than pure horizontal integration.

(c) **Financial Synergy**: Merger of entities brings with it many investment opportunities. A firm with abundant cash merging with cash starved firm opens new vistas and this is a very important gain in the post merger context. A combined firm can utilize its resources in the most optimum way and leverage its financial gains. As the investment opportunities emerge, more gains accrue to the organization.

(d) **Strategic Realignment**: Combination of existing firms gives significant positive benefits. It enables the firms to utilize the unused capacity and augment the present capabilities. This leverages the economies of scale and brings post merger gains. It also enables the merged entity to develop new capabilities and explore avenues to utilize the unused capacity.

(e) **Gains from Undervaluation**: Undervaluation at the time of merger is also possible. The institutional investors look at firms from a short term perspective and therefore entities with long terms investment horizon are undervalued and this results in gains to the investors with large resources.

(f) **Market Power**: Merger also creates greater market share and there by enhances the power of the combined entity in the market. The lesser the number of firms the greater is their dominance in the market. Even though the lesser number of firms can create cartels and thereby jeopardize the interest of consumers, it has been generally found that merger of companies has resulted in their wielding more power in the market and gaining more market share.

(g) **Tax Considerations**: Tax considerations also play an important role in the most merger scenario. Carry forward of accumulated losses and unabsorbed depreciation, waiver of capital gains tax to the firm etc. result in maximizing gains to the firm and the investors and this also creates more and more desire to restructure the organization.

We have outlined above some of the gains that will accrue to an organization after merger. These benefits will differ depending upon the nature of the organization, the type of merger, the consideration for merger and so on. But what is most important is that any restructuring activity if properly gone through will definitely benefit the organization to a large extent.

MEASURING POST MERGER EFFICIENCY

Business entities strive for growth. We had already seen restructuring is resorted to only to enhance growth. Merger of entities is desired only to add value to the combined entity. In a post merge situation, the outcome of merger has to be evaluated vary carefully. It is necessary that this evaluation of the business is continued for a desirably longer period so that the merged entity is appraised on a continuous basis for a greater length of time. There are four indicators on which the efficiency of the organization after merger can be evaluated. We shall try to evaluate these four key parameters to drive home the efficiency of an organization in the post merger period.

1. Operating Economies

This is one of the key indicators of post merger efficiency. Merging of two firms will create economies of scale as a result of greater volume of operations of the merged entity. The merged entity will have a larger marketing network, enhanced production capacity, better research and development facilities which will increase the economies of scale. This is more common in horizontal mergers. Better co-ordination facilities, greater market share, lower inventory levels, reduction of overheads are some of the common benefits that accrue in a post merger situation in vertical mergers. Even though a merger naturally brings with it its rewards, it is for the organizations to decide as to how to go about this task, so that an optimum sized firm is created in the post merger scenario. This will ensure better results and usher in greater rewards.

2. Financial Economies

Financial gain is the real reward for any merger. Earnings and cash flows are the areas of financial gain to the merged firm. It is in these areas the valuations are built in that enhance the profit of the firms. Revenue, Cost, investment and working capital are the areas to be monitored to know the efficiency of the firm in the post merger scene. Increase in revenue, decrease in cost, greater investment opportunities and optimum working capital are all indicators of potentially vibrant firm. These will definitely indicate the efficiency of the firm after merger. Debt repaying capacity is also another indicator as the merged entity becomes more capable of discharging its debts. But a heavier debt burden will definitely be a drag on the company. So the lesser the debt, the greater is the repaying capacity and the possibility of defaults

gets reduced. This strengthens the borrowing capacity and since more lenders are prepared to lend, funds can be raised at short notice. Tax gains are also derived by merged entity.

3. Growth

Growth is the aim of any organization at any point of time leave alone post merger. A merged firm increases its market share and consequently in elevated to a higher plane among its competitors. The key indicator to judge whether or not there is growth in the merged entity is the market price of the shares of the merged entity. The greater the market price, the greater is the growth. Moreover it also indicates greater potential to grow further. Merger in the current economic scenario has a greater growth appeal per se, and so growth of the firm and the consequent increase in profitability is also another very important indicator of the efficiency of the firm.

4. Efficiency of the Management

A firm is judged by its Management. However great the resources are, however capable the personnel are, however good the products are, if there is an inefficient management, everything will come to naught. Merger can result in two types of situations. A firm with inefficient management may merge with a firm which is efficiently managed. Or both the firms may have efficient management in which case the combined firm will have greater managerial synergy. It is not possible to think of two inefficiently managed firms merging with one another. Even if one of the firms is inefficiently managed, in a post merger scenario the merged firm will achieve greater heights as efficiency is an achievable parameter. Every management should have great desire and a longing to belong to the best. They must strive to create a niche for themselves. They must have the ability and the acumen to achieve the best in terms of market share, profit, capacity utilization and applicability of managerial skill. A good management will be judged by its relation with the employees and customers. If the employees of an organization are willing to contribute to the growth of the organization and see it as their own, it is an important indicator that the management had an impact on the employees. Customer satisfaction and garnering more market share is also an indicator of managerial efficiency. If a firm has contended employees willing to contribute to the growth of the organization and satisfied customers, it is indeed a sign of efficient management. Managerial efficiency is a great barometer of a successful merger.

FACTORS IN POST MERGER REORGANISATION

Post merger any entity has to contend with a host of factors that affect the stakeholders, entity at large and the management. These depend upon the situation in which the entity is placed and the integration that is sought to be achieved. We discuss some of these factors below:

a) Legal Compulsions

The entire process of merger is recognized by law. In a post merger scenario, the new entity will face a lot of legal obligations which it has to carry out in the changed situation. This will, of course, depend upon the size of the organization, the nature of its business, the marketing network it has inherited, debt profile etc. Added to this, there will be the statutory requirements to be complied with under the Companies Act 1956 and the regulatory bodies like the RBI. SEBI and the stock exchanges. The legal obligations to the different stakeholders like the shareholders, creditors, debenture holders should be complied with by the new management so that the new entity functions without any hassle.

b) Managerial Changes

A merger also brings with it changes in Management. The new entity should function with cohesion and for this the new management team of the board of directors and the top executives should be from personnel who understand the changed culture and the means to integrate the same for efficient functioning. Expertise in the business as well as the legal aspects of the entity, ability to plan and implement new strategies in the changed context are all the prerequisites in selecting the new team. The new management should be responsible towards accounting, management information system. corporate control and ensure effective co-ordination between different sections of the organization.

c) Financial Revamping

Financial planning and management is the most important aspect in any restructuring including merger. Inadequate cash flows, uncharacteristic balance sheet, depressing equity are all danger signals for the new entity. The clean up act should be done quickly. At the same time restructuring the financial aspects requires consent of creditors, RBI, SEBI and stock exchanges as per the statutory requirements. These have to be complied with. Revaluation of assets, change in

capital base, and relocation of reserves are all part of financial restructuring. It should be ensured that any restructuring should have the broad consent of different stake holders and comply with the requirements of law. At the same the main corporate concern of maintenance of adequate liquidity and optimum utilization of the resources should be kept in mind. All financial plans should be closely followed so that there is not any unwarranted derailment in the process.

d) Labour Relations

Post merger labour relations acquire a new dimension. Two aspects are to be factored in with care. Shedding of excess workforce and fine tuning the remaining employees to the changed situation are the two areas in which the management has to concentrate in the post merger scene. Increase in productivity and the return on capital employed are basically the reasons for restructuring and if this has to be achieved the labour force should be put to optimum use.

e) Strategies in Core Areas

The two core areas of any business are production and marketing. Utilising the production capacity to the maximum extent, increasing productivity, adapting new technical and technological initiatives in the different stages of production are all vital to the production of any undertaking. Similarly marketing in a competitive environment requires lot of effort and enterprise. The strategy that is adopted to garner a larger share in the market is an important area of marketing. Market analysis, market surveys and developing a wide marketing network involving different strata's are all important for healthy marketing.

f) Advantages to Stake Holders

The stake holders always look forward to any merger activity with hope so that they may get better price for their investment. It has been seen in a number of cases that once the entities decide to merge the activity in the share increases. The share price spikes up and thus the shareholders are rewarded. But the important thing to be kept in mind is that it is not always the case. It is because the gain in the share price depends on the strength of the companies and the consequences for the merged entity. So depending upon the business of the company, its financial position and future prospects the shareholders stand to gain from the merger activity.

g) Corporate Control

Control is the essence of any business. In a post merger scenario this has all the more relevance. Corporate control should be exercised so that the new entity functions by utilizing its resources in the optimum way and achieves the desired productivity. The management should function effectively so the all the corporate plans in the post merger situation are implemented in the most effective way. The management should make use of the different control techniques like Budgetary Control, Standard Costing, Financial Ratios and internal audit. In addition there are various modern management techniques which should also be utilized to exercise effective control. Techniques like Zero-base budgeting, Performance budgeting, Programme evaluation technique etc will also guide the management in its efforts to usher in effective control. Restructuring is primarily aimed increasing growth and profitability. The management should spare no effort to achieve these twin objectives to make the restructuring exercise meaningful.

Review Questions:

1. State the criteria for success of a restructuring exercise. Evaluate your answer in the light of the rules laid down by Peter F. Drucker.
2. State the gains to post merger valuation.
3. Profitability and growth are the essence of a restructuring exercise - Elaborate.
4. How is the efficiency of the organization measured in the post merger scenario?
5. Elucidate the factors that attain relevance in the post merger reorganization.

* * *

UNIT – 6

FINANCIAL RESTRUCTURING

INTRODUCTION

Financial restructuring is one of the several modes of restructuring we have discussed in the previous studies. There may be a stage in the functioning of the company in which it has to financially restructure itself in order to have a healthy capital gearing. Capital gearing simply means the relationship between the debt and equity. The company should always maintain a balance between debt and equity. If this balance is not there, then the company may face problems of liquidity or lack of working capital. In such a situation where the company is not able to meet its day to day commitments or is not able to convince its creditors to lend more to the company or cannot utilize its production capacity or desperately needs working capital then it needs to restructure itself financially. Restructuring of a company financially will involve balancing of its debt and equity. It may depend upon the ratio of debt and equity. It is normally believed that a debt –equity ratio of 2:1 is ideal for the company. Depending upon the ratio of debt to equity restructuring will involve injecting more capital or resorting to more borrowing or paying back surplus capital or repaying the debt. In this study we shall discuss one of the modes of financial restructuring, viz. share buy back, when the company is over-capitalized.

BUY BACK OF SHARES

The capital of a company is considered as the most sacrosanct element in the functioning of company. Therefore the corporate laws over decades have prohibited companies from parting with their capital however precarious the situation is. Even the Judiciary has ruled that a company cannot tinker with its capital that would have the effect of reducing it. Taking a cue from the English law, the Indian Companies Act 1956 prohibited a company from purchasing its own shares (Sec.77 of the Act). This was considered necessary to protect the interest of the creditors of the company. But with the globalization of the economy, it was considered necessary to restructure some of the provisions of the Companies Act to suit the change of times and in this context once significant change that was brought was to the concept of share buy back.

Sec.77A of the Companies Act inserted in to the Act with effect from 31.10.1998 by the Companies (Amendment) Act 1999 is an exception to the provisions of Sec.77 that were there hitherto.

Buy Back is reverse of issue of shares by a company where it offers to take back its own shares from the shareholders of the company at a specified price. The offer to the shareholders is optional, that is, the share holders can accept or reject the offer. It is pertinent to note here that a buy back has no impact on the fundamentals or the company. The investors should be cautious in respect of buy backs and should not fall in to the trap of the unscrupulous promoters who may resort to this method to hoodwink the shareholders.

CONCEPT OF BUY BACK

The Concept of buy back was introduced into the Companies Act 1956 with a view to give freedom to the management of the company to maintain a balance between the debt and equity. Prior to the amendment, the only recourse available to the companies was to reduce capital vide Sec.100 of the Companies Act 1956. The procedure under the section is cumbersome requiring not only the general body to ratify the proposal but involved the approval of the court. Further reduction of capital under the section was considered a stigma for the company which eroded its credibility. In the circumstances and with the global changes in the capital market scenario, it was considered imperative to introduce a new provision, which will empower the management to fine tune its debt and equity to suit the requirement of the company. Enhancing share holders value is the modern day corporate mantra and to achieve this, the company has to resort to several ways and means to keep the company financially viable with a balanced capital structure.

NEED FOR BUY BACK

A Company may have a variety of reasons for buy back of shares and securities. This will depend upon the financial position of the company, the overall economic scenario or the compulsion to get advantage of a particular situation. We will now discuss some of the reasons for buy back of shares and securities.

a) Surplus Cash:

A company may have huge cash reserves and not many profitable projects to invest and in such a scenario it may resort to buy back of shares to utilize its surplus cash reserve. Similarly if the company is of the view that its shares are undervalued then also it can resort to buy back. Examples being the buy back of Bajaj Auto in the year 2000 or the buy back of Reliance Industries recently. But it is generally felt that in a emerging market like India were capital is inadequate buy back is not a logical solution. On the contrary a lot of opportunities exist for companies for growth in countries like India. Share buy back is more suited to Multinational companies who have presence across markets, have adequate provision for Research and Development and incremental growth is limited.

b) Market Perception:

If the company predicts a fall in prices of its shares for a variety of reasons, then share buy back serves as a hedge against the predicted fall. There have been number of instances of companies resorting to buy back to prevent further fall in share price.

c) Shore up Value:

Buy back of shares reduces the equity of the company and also the assets as cash is an asset. After the buy back the return on equity and the return on Assets increases. Assuming that the earnings remain the same the EPS and P/E ratio will increase and will give share better value. For this purpose also share buy back can be resorted to.

d) Increase Promoters Stake

Share buy back can also be resorted to increase the stake of the promoters. This is particularly so where the promoters are of the view that there is a dilution in their stake and it should be stopped. Buy back of shares reduces the overall equity and increases the promoter's stake.

e) Easy means to Reduce Capital

Yet another reason for resorting to buy back is to reduce capital without recourse to the provisions of Sec.100 of the companies Act which is cumbersome.

f) **Exit Route:**

Where the shares of the company are unlisted buy back of shares provides an easy exit route to the shareholders of the company. This also indirectly encourages investors to invest in unlisted companies.

g) **Preventing Take over**:

Buy back of shares also aids in preventing take over by unscrupulous elements.

METHODS OF BUY BACK

Buy back of shares can be done in three ways.

(a) **Through a tender offer or Dutch auction**: In this method of buy back the share holders are given an option to surrender a portion of or all of their shares to the company at a price higher than the market price. In the alternative, as in a Dutch auction, the company indicates a range of prices at which it is willing to buy and accept the bids. In such cases the company buys at the lowest bid price the prescribed number of shares.

(b) Buy back can also be resorted to through a **book building process** as in the case of issue of shares. In this method, the price for the buy back is determined by the share holders themselves through open bidding on line.

(c) Buy back of shares can be done by the company as per the Regulations of the Companies Act 1956 and the SEBI Guidelines which may be termed as the **buy back as per regulations.**

PROCEDURE AND PRACTICE FOR BUY BACK OF SHARES

A Company resorting to buy back of shares should follow the provisions contained in Sec.77A, Sec.77AA and Sec.77B of the Companies Act 1956 inserted by the Companies (Amendment) Act 1999 retrospectively from 31.10.1998 and the SEBI (Buy back of Securities) Regulations 1998. A gist of some of the important regulations of the SEBI regarding buy back are reproduced in **Annexure I** to this study.

Conditions for Buy Back of Shares

To protect the interest of the small investors and to prevent the unscrupulous promoters and directors from using the stock market as a money provider, the Act and the SEBI regulations provide for a number of conditions and restrictions for buy back of shares. We shall now proceed to look into these conditions which the companies have to follow while resorting to buy back of shares.

1) A Buy back of shares **must be authorized by the articles** of association of the company. If there is no authority in the articles, then they have to be suitably amended as per the Companies Act 1956 to incorporate the provision for buy back of shares.

2) Buy back of shares can be resorted to under Sec.77A **only from out of the free reserves or balance in Share premium Account** or the proceeds of any issue of shares or securities other than an earlier issue of the same kind.

3) A buy back **must be equal to or less than 25% of the paid capital and free reserves of the Company for that financial year** in which buy back is resorted to.

4) Buy back of shares must be approved by a **Special resolution of the Company in its General body**. However this special resolution is not necessary where the quantum of buy back of shares is not less than 10% of the paid up capital and free reserves of the company. In such cases, where the buy back of **shares does not exceed 10% as above**, it is enough if the Board of Directors of the Company passes a resolution to the effect.

5) 5) The **explanatory statement to the Special resolution stated above under Sec.173 of the Companies Act 1956**, shall contain interalia the reason for buy back, number of securities to be bought, the price at which the shares would be bought back, the gist of the report of the auditors regarding the financials of the company and confirmation by the board that they have adhered to the relevant provisions rules and regulations in the matter.

6) Post buy back the **debt equity ratio** of the company should not be more than 2:1. The shares to be bought back must be fully paid.

7) The buy back **must be completed within 12 months** from the date of passing of the Special resolution by the company. In case of buy back through the board resolution as mentioned in Clause 4 above, the buy back shall be completed in 365 days.

8) The company has the option to buy back its shares either from the existing share holders on a proportionate basis or from the open market through the book building process or from the odd lot of shares.

9) The company authorized to buy back it shares shall make a **public announcement regarding the buy back** with all material particulars in an English, Hindi and Regional daily having wide circulation at the place where the registered office of the Company is situated. The public announcement shall give full details of the buy back scheme, details of its capital structure, information regarding the listing and trading of its shares so as to acquaint the shareholders with full details of the company, its financials and the entire scheme of buy back.

10) Within 7 days of the public announcement **a letter of offer is to be filed with the SEBI with all disclosures** as given in the public announcement through a merchant banker. The letter of offer should also be sent to the shareholders of the company not earlier than 21 days before its submission to the SEBI.

11) **The public offer to the shareholders** to buy back their shares should contain interalia the date of opening and closing of the offer, the duration for which the offer will be kept open and how the shares buy back ratio would be arrived at in the event of the number of securities the shareholders are willing to offer exceeds the shares the company has decided to buy back.

12) The SEBI regulations stipulate that the company by way of security for performance of its obligation under the buy back scheme should deposit **in an escrow account** either as cash deposits with scheduled banks or bank guarantees or any acceptable securities with the merchant banker before the opening of the offer of buy back. The escrow amount as above shall be at least 25% of the obligation where the consideration does not exceed 100 crores and if it exceeds

100 crores then 25% up to 100 crores and 10% of the amount exceeding 100 crores.

13) The bank guarantee and the securities stated above shall be released after the company has complied with its obligations under the buy back scheme.

14) After the date of closing of the offer and within a period of 7 days the company shall **open a special account with a SEBI registered banker and deposit therein such amount which** together with the amount in the escrow account make up the entire sum due and payable to the shareholders whose shares are being bought back. The company should then proceed to make payment to the shareholders or if the buy back is not accepted return the securities. There is no provision for payment in installments.

15) The company should **extinguish and physically destroy** the share certificates within 7 days of the completion of buy back in the presence of the Registrar or Statutory auditor or merchant banker. If the securities are in the dematerialized form they should be destroyed as per the relevant SEBI regulations.

16) The company is required **to maintain a register of securities** bought back and destroyed. This register shall have particulars of securities bought, the consideration paid, date of cancellation, extinguishment and physical destroying of securities etc.

17) If a company **purchases its shares out of free reserves**, an amount equal to the nominal value of the shares purchased shall be transferred to the capital redemption reserve of the company and disclosed in the balance sheet.

18) The **particulars of all extinguished and destroyed certificates shall be given to stock exchanges** where the shares of the company are listed within 7 days.

19) Securities which are **under a lock in period and** securities which are not transferable shall not be bought back by the company.

20) After completion of all the formalities of buy back, the company shall file a return with the Registrar to the issue and the SEBI in the prescribed form with the full particulars as required there in.

21) In every buy back the company is required to give a declaration of solvency certified by the board by means of an affidavit that the company is completely solvent and will not become insolvent for at least a year.

BUY BACK OF SHARES THROUGH STOCK EXCHANGE

A company can buy back its shares through a stock exchange in the open market. In such a case the buy back should be through the electronic trading facility of the stock exchange and particularly thorough the order matching mechanism. All other conditions like the passing of the special resolution and the public announcement etc are similar to those as applicable as in a direct offer.

BUY BACK OF SHARES THROUGH BOOK -BUILDING

Buy back of shares can also be done through a book building process as in the case of issue of shares. The entire process should be carried out through an electronically linked transparent facility. The price would be fixed by the merchant banker in consultation with company and stock exchange based on the bids received and the highest bidders offer will be accepted. All other conditions remain the same.

UNLISTED AND PRIVATE COMPANIES

The procedure for buy back for private and unlisted companies is almost similar. The gist of the important regulations of the SEBI for these companies is given in **Annexure II**

ANNEXURE I

SECURITIES EXCHANGE BOARD OF INDIA

(BUY BACK OF SECURITIES) REGULATIONS 1998

(Some of the regulations which are directly relevant to the students are reproduced here)

DEFNITION:

Reg: 2 (h) 'merchant banker' means a merchant banker registered under Sec.12 of the Act.

2 (j) 'promoter' means 'promoter' as defined in Clause(h) of sub regulation (1) of Regulation 2 of the SEBI (substantial acquisition of shares and takeovers) Regulations 1997.

2 (k) 'registrar' means registrar to an issue and includes a securities transfer agent registered under Sec.12 of the Act.

2 (m) 'statutory auditor' means an auditor appointed by a company under Sec.224 of the Companies Act 1956.

2(o) 'tender offer' means an offer by a company to buy back its securities through a letter of offer from the holders of the securities of the company.

COMPANY MAY BUY BACK ITS OWN SHARES:

Reg: 4 (1) A company may buy back its securities by any one of the following methods:

a) from the existing security holders on a proportionate basis through a tender offer.

b) from open market through:

- book-building process,
- stock exchange
- from odd-lot holders.

(2) A company shall not buy back its securities from any person through negotiated deals, whether on or off the stock exchange or through spot transactions or through any private arrangement.

(3) An person or an insider shall not deal in securities of the company on the basis of unpublished information relating to buy back of securities of the company.

SPECIAL RESOLUTION

Reg: 5 (1) For the purpose of passing a special resolution under Sub section (2) of Sec.77A of the companies Act the explanatory statement to be annexed to the notice for the general meeting pursuant to Sec.173 of the Companies Act shall contain disclosures as specified in Schedule I.

(2) A copy of the resolution passed at the general meeting under Sub section (2) of Sec.77A of the Companies Act shall be filed with the Board and the stock exchanges where the securities of the company are listed within seven days from the date of passing of the resolution.

ADDITIONAL DISCLOSURES

Reg: 7 - The explanatory statement annexed to the notice under Sec.173 of the Companies Act 1956 shall contain the disclosures mentioned in Regulation 5 and also the following disclosures:

a) The maximum price at which the buy back of securities shall be made and whether the board of directors of the company are authorized at the general meeting to determine subsequently the specific price at which the buy back may be made at the appropriate time.

b) if the promoters intend to offer their securities

   - the quantum of securities proposed to be tendered and
   - the details of their transactions and their holdings for the last six months prior to the passing of the special resolution for buy back including information of number of securities acquired, the price and date of acquisition.

FILING OF OFFER DOCUMENTS ETC.

Reg: 8

(1) The company which has been authorized by a special resolution (or a resolution pass by the Board of Directors at its meeting) shall before buy back of securities make a public announcement in at least one English national daily, one Hindi national daily and a regional language daily all with wide circulation at the place where the registered office of the company is situated and shall contain all the material information as specified in Schedule II

(2) The public announcement shall specify a date which shall be the specified date for the purpose of determining the names of the security holders to whom the letter of offer shall be sent.

(3) The specified date shall not be earlier than thirty days and not later than forty two days from the date of the public announcement.

(4) The company shall within seven working days of the public announcement file with the board a draft letter of offer containing disclosures as specified in Schedule III through a merchant banker who is not associated with the company.

OFFER PROCEDURE

Reg: 9

(1) The offer for buy back shall remain open to the members for a period not less than fifteen days and not exceeding thirty days.

(2) The date of opening of the offer shall not be earlier than seven days or later than thirty days after the specified date.

(3) The letter of offer shall be sent to the security holders so as to reach the security holders before the opening of the offer.

(4) In case the number of securities offered by the security holders is more than the total number of securities to be bought back by the company, the acceptances per security holder shall be equal to the acceptances tendered by the security holders divided by the total acceptances received and multiplied by the total number of securities to be bought back.

(5) The company shall complete the verifications of the offers received within fifteen days of the closure of the offer and the securities lodged shall be deemed to be accepted unless a communication of rejection is made within fifteen days from the closure of the offer.

ESCROW ACCOUNT:

Reg: 10

(1) The company shall as and by way of security for performance of its obligations under the Regulations, on or before the opening of the offer deposit in an escrow account such sum as specified in sub regulation (2)

(2) The escrow amount shall be payable in the following manner:

- If the consideration payable does not exceed Rs.100 crores -25 percent of the consideration payable;
- if the consideration payable exceeds Rs.100 crores – 25 percent upto Rs.100 crores and 10 percent thereafter.

(3) The escrow account referred in sub regulation (1) shall consist of:

- cash deposited with a scheduled commercial bank or;
- bank guarantee in favour of the merchant banker or;
- deposit of acceptable securities with appropriate margin, with the merchant banker, or
- a combination of (a),(b) and (c) above.

(4) Where the escrow account consists of deposits with a scheduled commercial bank, the company shall, while opening the account, empower the merchant banker to instruct the bank to issue a bankers cheque or demand draft for the amount lying to the credit of the escrow account, as provided in the Regulations.

(5) Where the escrow account consists of bank guarantee, such bank guarantee shall be in favour of the merchant banker and shall be valid until thirty days after the closure of the offer.

(6) The company shall, in case the escrow account consists of securities, empower the merchant banker to realize the value of such escrow account by sale or otherwise and if there is any deficit on realization of the value of securities, the merchant banker shall be liable to make good any such deficit.

PAYMENT TO SECURITY – HOLDERS

Reg: 11

(1) The company shall immediately after the date of closure of the offer, open a special account with a banker to the issue registered with the Board and deposit therein, such sum as would together with the amount lying in the escrow account make-up the entire sum due and payable as consideration for buy back in terms of these regulations and for this purpose may transfer the funds from the escrow account.

(2) The company shall within seven days of the time specified in sub regulations (5) of regulation 9 make payment of consideration in cash to those security holders whose offer has been accepted or return the security certificates to the security holders.

EXTINGUISHMENT OF CERTIFICATES:

Reg: 12

(1) The company shall extinguish and physically destroy the security certificates so bought back in the presence of a registrar or the merchant banker and the statutory auditor within seven days from the date of acceptance of the securities.

(2) The securities offered for buy back if already dematerialized shall be extinguished and destroyed in the manner specified under the Securities and Exchange Board of India (Depositories and Participants) Regulations 1996 and the bye laws framed there under.

(3) The company shall furnish a certificate to the Board duly verified by:

- the registrar and whenever there is no registrar, through the merchant banker;

- two whole time directors including the managing director.
- the statutory auditor of the company, and
- Certifying compliance as specified in Sub Regulation (`, within seven days of the extinguishment and destruction of certificates.

(4) The particulars of the security certificates extinguished and destroyed under sub regulation (1) shall be furnished to the stock exchanges where the securities of the company are listed, within seven days of extinguishment and destruction of certificates.

ODD LOT BUY BACK

Reg: 13 - The provisions pertaining to buy back through tender offer as specified in this Chapter shall be applicable mutatis mutandis to odd lot shares.

BUY BACK FROM THE OPEN MARKET

REG: 14

(1) A company intending to buy back its securities from the open market shall do so in accordance with the provisions of this chapter.

(2) The buy back of securities from the open market may be in any one of the following methods:

- Through stock exchange
- Book-building process.

BUY BACK THROUGH THE STOCK EXCHANGE

REG:15

A company shall buy back its securities through the stock exchange as provided here under:

(a) The special resolution referred to in Regulation 5 or resolution passed by the Board of Directors at its meeting as referred to in

Regulation 5A shall specify the maximum price at which the buy back shall be made;

(b) The buy back of securities shall not be made from the promoters or persons in control of the company.

(c) The company shall appoint a merchant banker and make a public announcement as referred to in Regulation 8;

(d) The public announcement shall be made at least seven days prior to the commencement of buy back.

(e) A copy of the public announcement shall be filed with the Board within two days of such announcement along with the fees as specified in Schedule IV

(f) The public announcement shall also contain disclosures regarding the details of the brokers and stock exchanges through which the buy back of securities will be made.

(g) The buy back shall be made only on stock exchanges with electronic trading facility.

(h) The buy back of securities shall be made only through the order matching mechanism except 'all or none' order matching systems.

EXTINGUISHMENT OF CERTIFICATES

Reg: 16

(1) Subject to the provisions of sub regulation (2) the provisions of Regulation 12 pertaining to extinguishment of certificates shall be applicable mutatis mutandis.

(2) The company shall complete the verification of acceptances within the fifteen days of the pay out.

BUY BACK THROUGH THE BOOK BUILDING

(1) A company may buy back its securities through the book building process as provided here under:

(a) The special resolution referred to in Regulation 5 or the resolution passed by the Board of Directors at its meeting as referred to in the regulation 5A shall specify the maximum price at which the buy back shall be made.

(b) The company shall appoint a merchant banker and make a public announcement as referred to in Regulation 8

(c) The public announcement shall be made at least seven days prior to the commencement of buy back.

(d) Subject to the provisions of sub clauses (i) and (ii) the provisions of Regulation 10 shall be applicable:

- The deposit in escrow account shall be made before the date of the public announcement.
- The amount to be deposited in the escrow account shall be determined with reference to the maximum price as specified in public announcement.

(e) The public announcement shall also contain the detailed methodology of the book building process, the manner of acceptance, the format of acceptance to be sent by the security holders pursuant to the public announcement and the details of the bidding centres.

(f) The book building process shall be made through an electronically linked transparent facility.

(g) The offer for buy back shall remain open to the security holders for a period of not less than fifteen days and not exceeding thirty days.

EXTINGUISHMENT OF CERTIFICATES

Reg: 18 the provisions of Regulation 12 pertaining to extinguishment of certificates shall be applicable mutatis and mutandis.

OBLIGATIONS OF THE MERCHANT BANKER

Reg: 20

The merchant banker shall ensure that

(a) the company is able to implement the offer;

(b) the provisions relating to escrow account as referred to in Regulation 10 has been made;

(c) firm arrangements for monies for payment to full fill obligations under the offer are in place;

(d) the public announcement of buy back is made in terms of the regulations;

(e) the letter of offer has been filed in terms of regulations;

(f) the merchant banker shall furnish to the board a due diligence certificate which shall accompany the draft letter of offer.

(g) the merchant banker shall ensure that the contents of the public announcement of offer as well as the letter of offer are true, fair and adequate and quoting the source wherever necessary;

(h) the merchant banker shall ensure compliance of Section 77A and Sec.77B of the Companies Act and any other laws or rules as may be applicable in this regard.

(i) upon fulfillment of all obligations by the company under the regulations the merchant banker shall inform the bank with whom the escrow or special amount has been deposited to release the balance amount to the company;

(j) the merchant shall send a final report to the Board in the form specified within 15 days from the date of closure of the buy back offer.

(The above is a reproduction of some of the important SEBI regulations pertaining to buy back of shares)

ANNEXURE II

GOVERNMENT GUIDELINES FOR PRIVATE AND UNLISTED COMPANIES

PRIVATE LIMITED COMPANY AND UNLISTED PUBLIC LIMITED COMPANY (BUY-BACK OF SECURITIES) RULES 1999 - Issued by the Department of Company affairs, Government of India, vide notification no.GSR 502(E) dated 6th July 1999

APPLICABILITY:

Rule : 2 - These rules shall be applicable to buy back of equity shares or other specified securities of a private limited company and unlisted public limited company not listed on any recognized stock exchange.

BUYING BACK:

Rule: 3 - A company may buy back its shares by either of the following methods:

(a) from the existing shareholders on a proportionate basis through private offers;

(b) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.

SPECIAL RESOLUTION:

Rule: 4 The purpose of passing a special resolution under sub section (2) of Section 77A of the Companies Act, the explanatory statement to be annexed to the notice for the general meeting pursuant to Sec.173 of the said act shall contain disclosures as specified in the Schedule.

FILING OF LETTER OF OFFER:

Rule:5 (1) The company which has been authorized by a special resolution shall before buy back of shares file with the Registrar of Companies a draft letter of offer containing particulars specified in Schedule

(2) The company shall file along with the letter of offer, a declaration of solvency in Form No.4A prescribed under the Companies (Central Government's) General Rules and Forms 1956 and in accordance with the provisions of sub section (6) of Sec.77A of the Companies Act, 1956.

OFFER PROCEDURE:

Rule: 6 (1) The letter of offer shall be despatched immediately after filing with the Registrar of Companies but not later than 21 days from its filing with the Registrar of Companies.

(2) The offer of buy back shall remain open to the members for a period of not less than fifteen days and not exceeding thirty days from the date of despatch of the letter of offer.

(3) In case the number of shares offered by the shareholders is more than the total number of shares to be bought back by the company, the acceptance per shareholder shall be on a proportionate basis.

(4) The company shall complete the verifications of the offers received within 15 days of the closure of the offer and shares lodged shall be deemed to be accepted unless a communication of rejection is made within 21 days from the closure of the offer.

PAYMENT TO SHAREHOLDERS

Rule: 7 (1) The company shall immediately after the date of closure of the offer open a special bank account and deposit there in, such sum, as would make up the entire sum due and payable as consideration for the buy back in terms of these rules.

(2) The company shall within 7 days of the time specified in sub rule (4) of Rule 6 make payment of consideration in cash or bank draft/pay order to those shareholders whose offer has been accepted or return the share certificates to the shareholders forthwith.

GENERAL OBLIGATIONS OF THE COMPANY:

Rule: 8 The Company shall ensure that:

(a) The letter of offer shall contain true, factual and material information and shall not contain any misleading information and must state that the directors of the company accept the responsibility for the information contained in such documents;

(b) the company shall not issue any shares including by way of bonus till the date of closure of the offer under these rules;

(c) the company shall confirm in its offer the opening of separate bank account testifying the availability of funds earmarked for this purpose and pay the consideration only by way of cash or bank draft/pay order;

(d) the company shall not withdraw the offer to buy back after the draft letter of offer is filed with the Registrar of Companies.

(e) The company shall not utilize any money borrowed from banks/financial institutions for the purpose of buying back its shares.

RETURN TO BE FILED WITH REGISTRAR

Rule: 9 A company, after the completion of the buy back under these rules, shall file with the registrar a return in the specified form.

EXTINGUISHMENT OF CERTIFICATES

Rule:10

(1) The company shall extinguish and physically destroy the share certificates so bought back in the presence of the Company Secretary in whole time practice within 7 days from the date of acceptance of the shares.

(2) The company shall furnish a certificate to the Registrar of Companies duly verified by (a) two whole time directors including the Managing Director and (b) Company Secretary in whole time practice, certifying compliance of these rules including those specified in Sub-rule (1) above within seven days of the extinguishment and destruction of the certificates.

(3) The company shall maintain a record of share certificates which have been cancelled and destroyed within seven days of the buy back of shares.

REGISTER OF SHARES

Rule:11 The company shall maintain a register of shares bought back by the company in the specified format.

(The schedules have not been reproduced as gist of the same is given in the procedure for buy back)

Review Questions:

1. Buy back of shares means reducing the capital of the company. Examine this statement in the light of the sanctity accorded to Sec.77 of the Companies Act, 1956.
2. What is buy back of shares? When does a company resort to buy back?
3. What is the rationale for financial restructuring? Explain with reference to the need for capital and the burden of over capitalization.
4. State the procedure for buy back of shares from the shareholders.
5. The Government has stipulated guidelines for buy back by Pvt. Ltd and Unlisted public companies - Examine the guidelines with reference to the buy back procedure for these Companies.
6. State the salient features of buy back through the book building process.
7. State the obligations of the merchant banker under the buy back regulations.

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MODEL QUESTION PAPER

Paper 3.6 : CORPORATE RESTRUCTURING

Time : 3 hours Max : 100 marks

SECTION-A (5 x 8 = 40 marks)

Answer any **Five** questions

1. What is Core Competence with reference to an organization? How does it influence the restructuring process?
2. What is bail out takeovers? Explain with an example.
3. How is post merger efficiency measured?
4. State contents of the public announcement to be made under the buy back regulations.
5. State the different types of takeovers and explain briefly the salient features of each of them.
6. What is Reverse merger? When it is resorted to?
7. State the reasons for merger in the light of the high tend merger activity in the present economic scenario.
8. State the tax relief given to undertakings resorting to demerger.

SECTION-B (4 x 15 = 60 marks)

Answer any **Four** questions

9. State the important aspects to be taken into account in strategic planning. State the advantages of strategic planning in the restructuring process.
10. State the procedure for take over of companies with reference to the SEBI take over code.
11. What are the factors to be taken into account in post merger reorganization?
12. State the legal procedure to be followed by Companies for amalgamation under the provisions of the Companies Act, 1956.
13. What are the guidelines of the SEBI for buy back of shares from the shareholders?
14. State the differences between demergers and reconstruction with relative merits and demerits.
15. State the procedure to be followed by a company for holding the meeting of shareholders/creditors under a scheme of merger.

REFERENCE BOOKS

1. Hand book on Mergers, Amalgamations and Takeovers – Law and Practice - ICSI Publication.
2. Mergers, Restructuring and Corporate Control - J Fred Weston, K Wang S.Chung and Susan E.Hoag.
3. SEBI Manual - Taxmann
4. Corporate Restructuring: Law and Practice - ICSI Study Material.
5. Corporate mergers, Amalgamations and Takeovers - J.C. Verma.